S. Hrg. 102-152

ENVIRONMENTAL LENDER LIABILITY ISSUES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

SHOULD GOVERNMENT AGENCIES AND PRIVATE LENDING INSTITUTIONS BE FORCED TO PAY ENORMOUS SUMS TO CLEAN UP ENVIRONMENTAL CONTAMINATION THAT THEY DID NOT CAUSE?

AND

S. 651

TO IMPROVE THE ADMINISTRATION OF THE FEDERAL DEPOSIT INSURANCE CORPORATION, AND TO MAKE TECHNICAL AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT, THE FEDERAL HOME LOAN BANK ACT, AND THE NATIONAL BANK ACT

JUNE 12, 1991

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ENVIRONMENTAL LENDER LIABILITY ISSUES

WEDNESDAY, JUNE 12, 1991

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington DC.

The committee met, pursuant to notice, at 10:08 a.m., in room SD-538, Senate Dirksen Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome all those in attendance this morning.

Today, the committee will consider further the subject of lender liability and the potential environmental liability of private fiduciaries.

Senator Garn has introduced S. 651, which includes the Asset Conservation and Deposit Insurance Protection Act of 1991. This bill seeks to limit the environmental cleanup liability of lenders and fiduciaries, as well as certain Federal credit and Federal regulatory agencies.

We're here today to explore with these witnesses the nature and scope of the problems of lender and fiduciary environmental liability, whether the type of legislation advocated by Senator Garn is needed, and if so, what changes, if any, in the bill might be appropriate.

In today's hearing, I'm particularly interested in examining the following issues.

Is the availability of credit, particularly to small- and medium-size businesses, substantially constrained by the risks to lenders that arise under current environmental laws?

If it is, what are the impacts on the ability of borrowers, particularly small- and medium-size businesses, to compete in their respective industries?

Where should the buck stop in the Federal Government with respect to losses on environmental claims against lenders that benefit from the credit assistance of the Federal Government?

Is it appropriate that each of many Federal credit agencies be at risk with respect to such claims, or should some or all of these agencies be substantially insulated from this kind of environmental risk?

And then, what distinctions, if any, are appropriate between the limits of environmental liability that apply to Federal credit and financial regulatory agencies and those that are applicable to private lenders and fiduciaries?

I think we're fortunate to have some very knowledgeable persons to help us examine these issues. They are divided into two panels.

The first panel of public agency representatives includes Chairman William Seidman of the FDIC and RTC, Federal Reserve Board member Edward Kelley, J. French Hill, Deputy Assistant Secretary of the Treasury for Corporate Finance, and Ray Ludwiszewski, who is the Acting Assistant Administrator for Enforcement of the Environmental Protection Agency.

The second panel of private sector representatives includes Douglas Wolf of the National Resources Defense Council, Joseph Forte, on behalf of the American Bar Association, Harris Simmons for the American Bankers Association, and David Adcox, representing the Petroleum Marketers Association of America.

I want to say that Senator Garn has clearly been the leader in the Senate on this issue and feels very strongly about it. He's done a lot of work on it, and obviously will be instrumental in leading our effort on the committee in this area.

So Senator Garn, let me call on you now.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you very much, Mr. Chairman.

First of all, let me thank you for holding today's hearing on lender liability. The issues are really simple—should Government agencies and private lending institutions be forced to pay enormous sums to clean up environmental contamination that they did not cause?

Should Congress impose this liability without regard to the ultimate cost to the American taxpayer and to our economy? And the answer is no. The sooner we address this problem, the better.

Yesterday, the committee held a hearing on the RTC. Once again, we heard complaints that the RTC is not disposing of its assets—in particular, real estate assets—in a fast and efficient manner. Yet, the RTC is being hampered by the threat that it and potential purchasers may be assessed huge sums for environmental cleanup costs, even though RTC did not in any way cause or contribute to the environmental problem.

The same problem plagues the FDIC and the other Federal banking and lending agencies. This liability was never intended by the Congress. The original superfund legislation enacted in 1980 was supposed to limit the liability of secured lenders. We reaffirmed this limitation in the superfund amendments in 1986.

However, through several court decisions, the intent of Congress has not been fulfilled, leaving both Federal banking agencies and other secured lenders potentially liable for the costs of pollution for which they have no responsibility.

In addition, the mere threat of environmental liability is inhibiting the flow of credit to various sectors of our economy. In particular, the small business community. This is not only contributing to the credit crunch, but is also hurting the environment by cutting off funds that could be used to modernize plants or to install pollution control equipment.

Last year, during hearings in this committee, I urged the EPA and the FDIC to get together in order to take whatever regulatory action they could. Last week, the EPA released a proposed regulation intended to clarify the scope of liability for the banking agencies and private lenders.

I am very pleased that the administration heeded my advice and finally acted. Regulatory efforts to mitigate this problem are vital and this regulation, if actually promulgated as a final rule, will go a long way in this regard.

In fact, there are many provisions in the proposal that I believe could be incorporated into my bill, and I hope that the witnesses today would comment on whether they would recommend that approach.

But let there be no mistake. I believe that the regulation alone is not sufficient and that Congress must enact legislation.

First of all, there is considerable legal uncertainty whether this rule alone will be sufficient to override some of the court decisions interpreting the superfund act.

Second, the proposed regulation only deals with the superfund act, but other laws could create similar strict liability problems for both the lenders and the banking agencies.

Third, with respect to the banking agencies, the proposal does not protect subsequent purchasers. Without such a provision, the potential liability of the agencies will not be truly alleviated.

Finally, aside from the legal problems, I do not believe that Congress should abdicate its responsibility to set policy in this area. We in Congress have a duty to address this issue. We should not duck this responsibility by using the excuse that the EPA has issued a proposed regulation.

I had the opportunity 2 weeks ago to testify before a House subcommittee, and the response was very favorable on the House side, Mr. Chairman. As a matter of fact, I was rather surprised that everybody on both sides of the aisle said unequivocally that we should enact legislation and not rely upon the regulation.

Congressman John LaFalce, who was one of the first to comment about the Love Canal and try to do something about it, is certainly known as an environmentalist and his record in the House certainly proves that. Congressman LaFalce introduced legislation similar to my bill last year and again this year in the House and feels that it is vital that we separate liability of innocent lenders and the Federal agencies from the issue of environmental pollution.

I want to make it very clear, I was very discouraged last year by some of the comments of the environmental groups about how this would create new Love Canals.

It doesn't create anything. And this Senator doesn't want any more pollution created, no more superfund sites. This Senator wants to clean up those that already exist, for public health and safety and other reasons.

This is an issue of fairness. It is an issue of do you require people that have no responsibility, had nothing to do with the pollution to pay and exacerbate an already great financial catastrophe in this country?

That makes no sense. It isn't fair. It isn't equitable. It isn't democratic.

And I would hope that the environmental groups would separate the issue. This is not an attack on the environment. No one wants to do that. It is a matter of who pays for it. And innocent people in this country shouldn't be required to pay for something that they did not cause. That is why we created the superfund; if you can't find the responsible parties, then all of us as taxpayers should pay for the cleanup.

But if I sound a little bit angry, I am, because I don't understand the issue with the environmentalists, some environmentalists, on this. We agree these sites need to be cleaned up and we need to prevent future sites. That isn't the question.

But how anybody can be for sticking innocent lenders and adding to the S&L crisis and the problems of the RTC and FDIC is beyond my comprehension. I've been around here for 17 years and I've seen a lot of issues come and go. Some are fair and some are unfair. But let's get on the same playing field on this and separate the environmental issues from the fairness issue.

Mr. Chairman, again, I appreciate your holding this hearing. I hope we can move. We should have moved last year on this. In fact, Mr. Seidman testified at the end of last year in response to my question, knowing we were running out of time, what could we do to help him in his job? We obviously couldn't produce big changes to the RTC. We obviously couldn't produce a massive banking bill at that time.

He said his No. 1 priority, if we could do something before the end of the session, was to pass this legislation.

Now I have no pride of authorship. It doesn't have to be the exact words that I have written. There is certainly room for compromise. There's room for change. But there is no room for not solving this problem in some way.

So I hope that we can come together and have some fairness and equity in this body, and separate the environmental issues from the fairness issues of who pays.

Thank you, Mr. Chairman.

[Copy of prepared bill S. 651 follows:]

II

102D CONGRESS
1ST SESSION

S. 651

To improve the administration of the Federal Deposit Insurance Corporation, and to make technical amendments to the Federal Deposit Insurance Act, the Federal Home Loan Bank Act, and the National Bank Act.

IN THE SENATE OF THE UNITED STATES

MARCH 13 (legislative day, FEBRUARY 6), 1991

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To improve the administration of the Federal Deposit Insurance Corporation, and to make technical amendments to the Federal Deposit Insurance Act, the Federal Home Loan Bank Act, and the National Bank Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Federal Deposit Insurance Improvements Act of 1991".

(b) TABLE OF CONTENTS.—

TITLE I—AMENDMENTS TO FEDERAL BANKING ACTS

SUBTITLE A—IMPROVEMENTS

Sec. 101. Short title; table of contents.

Sec. 102. Terms of office.
Sec. 103. Conversions.
Sec. 104. Temporary suspension of deposit insurance.
Sec. 105. Priority of claims.
Sec. 106. Repealer.
Sec. 107. Disclosure of uninsured status.
Sec. 108. Asset disposition amendments.
Sec. 109. Penalties.
Sec. 110. Appointment of receiver.

SUBTITLE B—ASSET CONSERVATION AND DEPOSIT INSURANCE PROTECTION

Sec. 151. Short title.
Sec. 152. Amendment to the Federal Deposit Insurance Act.

SUBTITLE C—AMENDMENTS TO PUBLIC LAW 96-510.

Sec. 171. Conforming amendments.

TITLE II—CLARIFYING AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

Sec. 201. FSLIC resolution fund.
Sec. 202. Branching.
Sec. 203. Removal.

TITLE III—TECHNICAL AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

Sec. 301. Technical amendments.

TITLE I—AMENDMENTS TO FEDERAL BANKING ACTS

Subtitle A—Improvements

SEC. 101. SHORT TITLE.

This subtitle may be cited as the "Federal Banking Agency Improvements Act of 1991".

SEC. 102. TERMS OF OFFICE.

Section 2(c) of the Federal Deposit Insurance Act (12 U.S.C. 1812(c)) is amended to read as follows:

"(c) TERMS.—

"(1) APPOINTED MEMBERS.—Each appointed member shall be appointed for a term of 6 years.

"(2) INTERIM APPOINTMENTS.—Any member appointed to fill a vacancy occurring 2 or more years before the expiration of the term for which such member's predecessor was appointed shall be appointed only for the remainder of such term. Any member appointed to fill a vacancy occurring within 2 years of the expiration of the term for which such member's predecessor was appointed shall be appointed for a new term of 6 years.

"(3) CONTINUATION OF SERVICE.—The Chairperson, Vice Chairperson, and each appointed member may continue to serve after the expiration of the term of office to which such member was appointed until a successor has been appointed and qualified. This provision applies notwithstanding the date on which such member was initially appointed.".

SEC. 103. CONVERSIONS.

Section 5(d)(2)(C) of the Federal Deposit Insurance Act (12 U.S.C. 1815(d)(2)(C)) is amended to read as follows:

"(C) APPROVAL DURING MORATORIUM.—The Corporation may approve a conversion transaction at any time if—

"(i) the conversion transaction affects an insubstantial portion, as determined by the Corporation, of the total deposits of each depository institution acquired as part of such conversion transaction;

"(ii) the conversion occurs in connection with the acquisition of a Savings Association Insurance Fund member in default or in danger of default, and the Corporation determines that the estimated financial benefits to the Savings Association Insurance Fund or Resolution Trust Corporation equal or exceed the Corporation's estimate of the loss of assessment income to such insurance fund over the remaining balance of the 5-year period referred to in subparagraph (A), and the Resolution Trust Corporation concurs in the Corporation's determination; or

"(iii) the conversion occurs in connection with the acquisition of a Bank Insurance Fund member in default or in danger of default and the Corporation determines that the estimated financial benefits to the Bank Insurance Fund equal or exceed the Corporation's estimate of loss of assessment income to the insurance fund over the remaining balance of the 5-year period referred to in subparagraph (A).".

SEC. 104. TEMPORARY SUSPENSION OF DEPOSIT INSURANCE.

Section 8(a)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1818(a)(8)) is amended—

(1) by amending subparagraph (A) to read as follows:

"(A) IN GENERAL.—If, the Board of Directors, after consultation with the appropriate Federal banking agency, finds that an insured depository institution (other than a savings association to which subparagraph (B) applies) has no tangible capital under the capital guidelines or regulations of the appropriate Federal banking agency, the Corporation may issue a temporary order suspending deposit insurance on all deposits received by the institution."; and

(2) by amending subparagraph (C) to read as follows:

"(C) EFFECTIVE PERIOD OF TEMPORARY ORDER.—Any order issued under subparagraph (A) shall become effective not earlier than 10 days from the date of service upon the institution and, unless set aside, limited, or suspended by a court in a proceeding authorized hereunder, shall remain effective until an order of the Board under paragraph (3) becomes final or until the Corporation otherwise dismisses or sets aside the order.".

SEC. 105. PRIORITY OF CLAIMS.

Section 11 of the Federal Deposit Insurance Act (12 U.S.C. 1821) is amended by adding at the end the following:

"(s) PRIORITY OF CERTAIN CLAIMS.—In any proceeding relating to a claim acquired under this section or section 13 against an insured depository institution's director, officer, employee, agent, attorney, accountant, appraiser, or any other person employed by or providing services to an insured depository institution, any suit, claim, or cause of action brought by the Corporation shall have priority over any other suit, claim, or cause of action asserted by depositors, creditors, or shareholders of the depository institution, except for claims of Federal agencies brought pursuant to section 6321 of the Internal Revenue Code of 1986 or section 3713 of title 31, United States Code. This priority shall apply to both the prosecution of any claim and to the execution of any subsequent judgments resulting from such action.".

SEC. 106. REPEALER.

Section 18(m) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)) is amended by striking paragraph (5).

SEC. 107. DISCLOSURE OF UNINSURED STATUS.

Section 28(h) of the Federal Deposit Insurance Act (12 U.S.C. 1828(h)) is amended to read as follows:

"(h) DISCLOSURES BY UNINSURED DEPOSITORY INSTITUTIONS.—

"(1) IN GENERAL.—Any depository institution the deposits of which are not insured by the Corporation shall disclose clearly and conspicuously in periodic statements of account and in all advertising that the institution's deposits are not 'federally insured'.

"(2) MANNER AND CONTENT.—The Corporation may, by regulation or order prescribe the manner and content of the disclosures required by paragraph (1).

"(3) ENFORCEMENT.—Compliance with the requirements of this subsection, and any regulation prescribed or order issued under this subsection, shall be enforced under section 8 in the same manner and to the same extent as if the depository institution were an insured State nonmember bank.".

SEC. 108. ASSET DISPOSITION AMENDMENTS.

Section 21A of the Federal Home Loan Bank Act (12 U.S.C. 1441a) is amended—

(1) in subsection (b), by amending paragraph (12) to read as follows:

"(12) REGULATIONS, POLICIES, AND PROCEDURES.—

"(A) IN GENERAL.—Subject to the review of the Oversight Board, the Corporation shall adopt the rules, regulations, standards, policies, procedures, guidelines, and statements necessary to implement the strategic plan established by the Oversight Board under subsection (a)(14). The Corporation may issue such rules, regulations, standards, policies, procedures, guidelines, and statements as the Corporation considers necessary or appropriate to carry out this section.

"(B) REVIEW, ETC.—Such rules, regulations, standards, policies, procedures, guidelines, and statements—

"(i) shall be provided by the Corporation to the Oversight Board promptly or prior to publication or announcement to the extent practicable;

"(ii) shall be subject to the review of the Oversight Board as provided in subsection (a)(6)(C); and "(iii) shall be promulgated pursuant to subchapter II of chapter 5 of title 5, United States Code.

"(C) PREPARATION AND MAINTENANCE OF RECORDS RELATING TO SOLICITATION AND ACCEPTANCE OF OFFERS.—The Corporation shall—

"(i) document decisions made in the solicitation and selection process and the reasons for the decisions; and

"(ii) maintain such documentation in the offices of the Corporation, as well as any other documentation relating to the solicitation and selection process.

"(D) REAL ESTATE ASSET DIVISION.—The Corporation shall establish a Real Estate Asset Division to assist and advise the Corporation with respect to the management, sale, or other disposition of real property assets of institutions described in paragraph (3)(A). The Real Estate Asset Division shall have such duties as the Corporation establishes, including the publication of an inventory of real property assets of institutions subject to the jurisdiction of the Corporation. Such inventory shall be published before January 1, 1990 and updated semiannually thereafter and shall identify properties with natural, cultural, recreational, or scientific values of special significance.

"(E) SUPPORT STAFF.—The Corporation shall maintain an executive-level position and dedicated staff to assist and advise the Corporation and other agencies in pursuing cases, civil claims, and administrative enforcement actions against institution-affiliated parties of insured depository institutions under the jurisdiction of the Corporation. These personnel shall have such duties as the Corporation establishes, including the duty to compile and publish a report of the Congress on the coordinated pursuit of claims by all Federal financial institution regulatory agencies, including the Department of Justice and the Securities and Exchange Commission. The report shall be published before December 31, 1990 and updated semiannually after such date.";

(2) in subsection (c), by amending paragraph (6)(A) to read as follows:

"(A) PURCHASE LOAN.—The Corporation may provide a loan at market interest rates to the purchaser of eligible residential property for all or a portion of the purchase price, which loan shall be secured by a first or second mortgage on the property. The Corporation may provide such a loan at below market interest rates to the extent necessary to facilitate an expedited sale of eligible residential property and permit—

"(i) a lower-income family to purchase an eligible single family property under paragraph (2); or

"(ii) a public agency or nonprofit organization to comply with the lower-income occupancy requirements applicable to the purchase of an eligible residential property under paragraph (2) or (3). The Corporation shall provide such loan in a form which would permit its sale or transfer to a subsequent holder."; and

(3) in subsection (c), by amending paragraph (9) to read as follows:

"(9) DEFINITIONS.—For purposes of this subsection—

"(A) ADJUSTED INCOME.—The term 'adjusted income' has the same meaning as such term has under section 3 of the United States Housing Act of 1937.

"(B) CLEARINGHOUSES.—The term 'clearinghouses' means—

"(i) the State housing finance agency for the State in which an eligible residential property is located,

"(ii) the Office of Community Investment (or other comparable division) within the Federal Housing Finance Board, and

"(iii) any national nonprofit organizations (including any nonprofit entity established by the corporation established under title IX of the Housing and Community Development Act of 1968) that the Corporation determines has the capacity to act as a clearinghouse for information.

"(C) CORPORATION.—The term 'Corporation' means the Resolution Trust Corporation either in its corporate capacity or as receiver, but does not include the Corporation in its capacity as an operating conservator.

"(D) ELIGIBLE MULTIFAMILY HOUSING PROPERTY.—The term 'eligible multifamily housing property' means a property consisting of more than 4 dwelling units—

"(i) to which the Corporation acquires title; and

"(ii) that has an appraised value that does not exceed the applicable dollar amount set forth in section 221(d)(3)(ii) of the National Housing Act for elevator-type structures (without regard to any increase of such amount for high-cost areas).

"(E) ELIGIBLE RESIDENTIAL PROPERTY.—The term 'eligible residential property' includes eligible single family properties and eligible multifamily housing properties.

"(F) ELIGIBLE SINGLE FAMILY PROPERTY.—The term 'eligible single family property' means a 1- to 4-family residence (including a manufactured home)—

"(i) to which the Corporation acquires title; and

"(ii) that has an appraised value that does not exceed the applicable dollar amount set forth in the first sentence of section 203(b)(2) of the National Housing

Act (without regard to any increase of such amount for high-cost areas).

"(G) LOWER-INCOME FAMILIES.—The term 'lower-income families' means families and individuals whose incomes do not exceed 80 percent of the median income of the area involved, as determined by the Secretary, with adjustment for family size.

"(H) NONPROFIT ORGANIZATION.—The term 'nonprofit organization' means a private organization (including a limited equity cooperative)—

"(i) no part of the net earnings of which inures to the benefit of any member, shareholder, founder, contributor, or individual; and

"(ii) that is approved by the Corporation as to financial responsibility.

"(I) PUBLIC AGENCY.—The term 'public agency'—

"(i) means any Federal, State, local, or other governmental entity; and

"(ii) includes any public housing agency.

"(J) QUALIFYING HOUSEHOLD.—The term 'qualifying household' means a household (i) who intends to occupy eligible single family property as a principle residence; and (ii) whose adjusted income does not exceed 115 percent of the median income for the area, as determined by the Secretary, with adjustment for family size.

"(K) QUALIFYING MULTIFAMILY PURCHASER.—The term 'qualifying multifamily purchaser' means (i) a public agency, (ii) a nonprofit organization, or (iii) a for-profit entity which makes a commitment (for itself or any related entity) to satisfy the lower-income occupancy requirements specified under paragraph (3)(E) for any eligible multifamily property for which an offer to purchase is made during or after the periods specified under paragraph (3).

"(L) RURAL AREA.—The term 'rural area' has the meaning given such term in section 520 of the Housing Act of 1949.

"(M) SECRETARY.—The term 'Secretary' means the Secretary of Housing and Urban Development.

"(N) STATE HOUSING FINANCE AGENCY.—The term 'State housing finance agency' means the public agency, authority, corporation, or other instrumentality of a State that has the authority to provide residential mortgage loan financing throughout such State.

"(O) VERY LOW-INCOME FAMILIES.—The term 'very low-income families' means families and individuals whose incomes do not exceed 50 percent of the median income of the area involved, as determined by the Secretary, with adjustment for family size.".

SEC. 109. PENALTIES.

Section 8(j) of the Federal Deposit Insurance Act (12 U.S.C. 1818(j)) is amended to read as follows:

"(j) Whoever, being subject to an order in effect under subsection (e) or (g), without the prior written approval of the appropriate Federal financial institutions regulatory agency, knowingly participates, directly or indirectly, in any manner (including by engaging in an activity specifically prohibited in such an order or in subsection (e)(6)) in the conduct of the affairs of—

"(1) any insured depository institution;

"(2) any institution treated as an insured bank under subsection (b)(3) or (b)(4), or as a savings association under subsection (b)(8);

"(3) any insured credit union (as defined in section 101(7) of the Federal Credit Union Act);

"(4) any institution chartered under the Farm Credit Act of 1971;

"(5) any appropriate Federal depository institution regulatory agency;

"(6) the Federal Housing Finance Board and any Federal Home Loan Bank; or

"(7) the Resolution Trust Corporation,

shall be fined not more than $1,000,000, imprisoned for not more than 5 years, or both.".

SEC. 110. APPOINTMENT OF RECEIVER.

Section 1 of the Act of June 30, 1876 (12 U.S.C. 191) is amended to read as follows:

"SECTION 1. APPOINTMENT OF RECEIVER.

"The Comptroller of the Currency may, without notice or prior hearing, appoint a receiver to take possession and control of a national bank (as defined in the Bank Conservation Act) whenever the Comptroller determines that one or more of the following circumstances exists:

"(1) the bank is not likely to be able to meet the demands of its depositors or pay its obligations in the normal course of business;

"(2) the bank is in an unsafe or unsound condition to transact business, including having substantially insufficient capital or otherwise;

"(3) the bank has incurred or is likely to incur losses that will deplete all or substantially all of its capital and there is no reasonable prospect for the bank's capital to be replenished without Federal assistance;

"(4) there is a violation or violations of laws, rules, or regulations, or there exists any unsafe or unsound practice or condition that is likely—

"(A) to cause insolvency or substantial dissipation of assets or earnings, or

"(B) to weaken the bank's condition or otherwise seriously prejudice the interests of its depositors; or

"(5) the bank has been dissolved, or its rights, privileges, and franchise have been declared forfeited, as prescribed in section 5239 of the Revised Statutes.".

Subtitle B—Asset Conservation and Deposit Insurance Protection

SEC. 151. SHORT TITLE.

This subtitle may be cited as the "Asset Conservation and Deposit Insurance Protection Act of 1991".

SEC. 152. AMENDMENT TO THE FEDERAL DEPOSIT INSURANCE ACT.

(a) IN GENERAL.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding at the end the following new section:

"SEC. 36. ASSET CONSERVATION.

"(a) LIABILITY LIMITATIONS.—

"(1) INSURED DEPOSITORY INSTITUTIONS.—The liability of an insured depository institution under any Federal law imposing strict liability for the release or threatened release of a hazardous substance at or from property—

"(A) acquired through foreclosure;

"(B) held in a fiduciary capacity;

"(C) held by a lessor pursuant to the terms of an extension of credit; or

"(D) subject to financial control or financial oversight pursuant to the terms of an extension of credit, shall be limited to the actual benefit conferred on such institution by a removal, remedial, or other response action undertaken by another party.

"(2) MORTGAGE LENDERS.—The liability of a mortgage lender under Federal law imposing strict liability for the release or threatened release of a hazardous substance at or from property—

"(A) acquired through foreclosure; or

"(B) subject to financial control or financial oversight pursuant to the terms of an extension of credit,

shall be limited to the actual benefit conferred on such institution by a removal, remedial, or other response action undertaken by another party.

"(3) UNEXERCISED CAPACITY TO INFLUENCE.—Notwithstanding paragraphs (1) and (2), an insured depository institution or mortgage lender shall not be liable under any Federal law described in paragraph (1) or (2) based solely on the fact that the institution or lender has the unexercised capacity to influence operations at or on property in which it has a security interest.

"(b) ACTUAL BENEFIT.—For purposes of this section, the actual benefit conferred on an institution or company by a removal, remedial or other response action shall not exceed the fair market value of the property following such action.

"(c) EXCLUSION.—The limitation on liability provided under subsection (a) shall not apply to—

"(1) any person that has caused or contributed to the release of a hazardous substance that forms the basis for liability described in subsection (a);

"(2) any person that, following the acquisition of property through foreclosure or the termination of a lease agreement, failed to take reasonable steps to prevent the continued release of a hazardous substance that forms the basis for liability described in subsection (a), if such release is discovered by such person prior to or after that acquisition or termination of the lease; or

"(3) any person that actively directs or conducts operations that result in the release of a hazardous substance that forms the basis for liability described in subsection (a).

"(d) GOVERNMENTAL ENTITIES.—

"(1) BANKING AND LENDING AGENCIES.—A Federal banking or lending agency shall not be liable under any law imposing strict liability for the release or threatened release of a hazardous substance from property acquired—

"(A) in connection with the exercise of receivership or conservatorship authority or the liquidation or winding up of the affairs of an insured depository institution, including any of its subsidiaries;

"(B) in connection with the provision of loans, discounts, advances, or other financial assistance; or

"(C) in connection with property received in any civil or criminal proceeding, or administrative enforcement action, whether by settlement or order.

"(2) LIMITATION.—The immunity provided by paragraph (1) shall not apply to any entity that has caused or contributed to the release of a hazardous substance that forms the basis for a liability described in paragraph (1).

"(3) SUBSEQUENT PURCHASER.—The immunity provided by paragraph (1) shall extend to the first subsequent purchaser of property described in such paragraph from a Federal banking or lending agency, unless such purchaser—

"(A) would otherwise be liable or potentially liable for all or part of the costs of the removal, remedial, or other response action due to a prior relationship with the property;

"(B) is or was affiliated with or related to a party described in (A); or

"(C) fails to take reasonable steps to prevent the continued release of a hazardous substance that gives rise to a removal, remedial, or other response action, if such release is discovered by such purchaser prior to or after such purchase.

"(4) LIMITED LIABILITY FOR EMERGENCY RESPONSE ACTIONS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), a Federal banking or lending agency shall not be liable for costs or damages in connection with actions taken in response to an emergency created by the release or threatened release of a hazardous substance from a property described in paragraph (1). Such response actions shall not be considered to have caused or contributed to damages resulting from such release or threatened release.

"(B) GROSS NEGLIGENCE STANDARD.—This paragraph does not preclude liability for costs or damages resulting from the gross negligence or intentional misconduct by a Federal banking or lending agency in responding to an emergency created by the release or threatened release of a hazardous substance in connection with a property described in paragraph (1).

"(C) DEFINITION.—For the purpose of this paragraph, the term 'gross negligence' means reckless, willful, or wanton misconduct.

"(e) LIEN EXEMPTION.—Any property transferred pursuant to subsection (d) or held by a Federal banking or lending agency shall not be subject to any lien for costs or damages associated with the release or threatened release of a hazardous substance known to exist at the time of the transfer.

"(f) EXEMPTION FROM COVENANTS TO REMEDIATE.—A Federal banking or lending agency shall be exempt from any law requiring such agency to grant covenants warranting that remedial action has been, or will in the future be, taken with respect to property acquired in the manner described in subsection (d)(1).

"(g) DUE DILIGENCE.—

"(1) DEPOSITORY INSTITUTIONS.—The appropriate Federal financial institutions regulatory agencies shall, after consulting with the Administrator of the Environmental Protection Agency, promulgate regulations that require insured depository institutions to develop and implement adequate procedures to evaluate actual and potential environmental risks that may arise from or at property prior to making an extension of credit secured by such property. The regulations may provide for different types of environmental assessments in order to account for different levels of risk that may be posed by different classes of collateral.

"(2) MORTGAGE LENDERS.—The Secretary of Housing and Urban Development shall, after consultation with the Administrator of the Environmental Protection Agency, promulgate regulations to assure that mortgage lenders develop and implement procedures to evaluate actual and potential environmental risks that may arise from or at property prior to making an extension of credit secured by such property. The regulations may provide for different types of environmental assessments in order to take into account the level of risk that may be posed by particular classes of collateral.

"(3) FINAL REGULATIONS.—Final regulations required to be promulgated pursuant to paragraph (1) shall be issued within 180 days after the date of enactment of this section.

"(h) DEFINITIONS.—For the purposes of this section:

"(1) The term 'property acquired through foreclosure' means property acquired from a nonaffiliated party by an insured depository institution or mortgage lender—

"(A) through purchase at sales under judgment or decree, power of sales, or from a trustee, deed in lieu of foreclosure, or similar conveyance, or through repossession, if such property was security for an extension of credit previously contracted;

"(B) through conveyance pursuant to an extension of credit previously contracted; or

"(C) through any other formal or informal manner by which the insured depository institution or mortgage lender temporarily acquires, for subsequent disposition, possession of collateral in order to protect its security interest.

Property is not acquired through foreclosure if it is property held for investment purposes, or if the insured depository institution or mortgage lender does not seek to sell or otherwise divest such property at the earliest practical time, taking into account market conditions and regulatory requirements.

"(2) The term 'mortgage lender' means a company (other than an insured depository institution) that—

"(A) is regularly engaged in the business of making extensions of credit secured, in whole or in part, by real property to nonaffiliated parties, and

"(B) complies with the environmental assessment requirements imposed under subsection (g), after final regulations under that subsection become effective.

The term 'mortgage lender' also includes the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation if such Association or Corporation complies with regulations promulgated by the Secretary of Housing and Urban Development to assure that environmental risks are considered by lenders prior to the acquisition of mortgage obligations or interests therein from such lenders.

"(3) The term 'fiduciary capacity' means acting for the benefit of a nonaffiliated person as a trustee, executor, administrator, custodian, guardian of estates, receiver, conservator, committee of estates of lunatics, or any similar capacity.

"(4) The term 'extension of credit' includes lease transactions that are functionally equivalent to a secured loan and that are authorized by and comply with regulations issued by the appropriate Federal banking agency or State banking authority.

"(5) The term 'insured depository institution' has the same meaning as in section 3(c), and shall also include—

"(A) a federally insured credit union;

"(B) a leasing company that is an affiliate of an insured depository institution; and

"(C) a farm credit bank or association chartered under the Farm Credit Act of 1971, as amended.

"(6) The term 'Federal banking or lending agency' means the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Board of Governors of the Federal Reserve System, a Federal Reserve Bank, a Federal Home Loan Bank, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration Board, the Farm Credit Administration, the Farm Credit System Insurance Corporation, and the Small Business Administration, in any of their capacities, and their agents.

"(7) The term 'appropriate Federal financial institutions regulatory agency' has the same meaning given such term in section 8(e), except that it does not include the Secretary of the Treasury or the Oversight Board.

"(8) The term 'release' has the meaning given such term in section 101(22) of Public Law 96–510, and also includes the use, storage, disposal, treatment, generation, or transportation of a hazardous substance.

"(9) The term 'hazardous substance' includes any substance or material that is subject to regulation or response under Federal or State environmental laws or regulations.

"(i) SAVINGS CLAUSE.—Nothing in this section shall affect the rights or immunities or other defenses that are available under other applicable law to any person subject to the provisions of this section.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall become effective upon the date of enactment of this subtitle, except that it shall not affect any administrative or judicial claims that have been formally filed as of such date.

Subtitle C—Amendments to Public Law 96–510

SEC. 171. AMENDMENTS.

(a) DEFINITIONS.—Section 101 of Public Law 96–510 is amended—

(1) in paragraph (20), by striking subparagraph (D); and

(2) in paragraph (35)(A)(ii), by inserting "State or Federal" before "government".

(b) FEDERAL BANKING OR LENDING AGENCY LIABILITY.—Section 107(d)(2) of Public Law 96–510 is amended by inserting "or Federal banking or lending agency (as defined in section 36 of the Federal Deposit Insurance Act)" after "local government", each time it appears.

TITLE II—CLARIFYING AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 201. FSLIC RESOLUTION FUND.

Section 11A(a) of the Federal Deposit Insurance Act (12 U.S.C. 1821a(a)) is amended to read as follows:

"SEC. 11A. FSLIC RESOLUTION FUND.

"(a) ESTABLISHED.—

"(1) IN GENERAL.—There is established a separate fund to be designated as the FSLIC Resolution

Fund which shall be managed by the Corporation and separately maintained and not commingled.

"(2) TRANSFER OF FSLIC ASSETS AND LIABILITIES.—

"(A) IN GENERAL.—Except as provided in section 21A of the Federal Home Loan Bank Act, all assets and liabilities of the Federal Savings and Loan Insurance Corporation on the date before the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 shall be transferred to the FSLIC Resolution Fund.

"(B) ADDITIONAL CLAIMS ON ASSETS.—The FSLIC Resolution Fund shall pay to the Savings Association Insurance Fund such amounts as are needed for administrative and supervisory expenses from the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 through September 30, 1991.

"(3) SEPARATE HOLDING.—Assets and liabilities transferred to the FSLIC Resolution Fund shall be the assets and liabilities of the Fund and not of the Corporation and shall not be consolidated with the assets and liabilities of the Bank Insurance

Fund, or the Corporation for accounting, reporting, or any other purpose.

"(4) USE OF FDIC POWERS.—As of August 10, 1989, the Corporation shall have all of the powers and rights to carry out its duties with respect to the assets and liabilities of the FSLIC Resolution Fund as the Corporation otherwise has under this Act.

"(5) CORPORATION AS RECEIVER.—As of August 10, 1989, the Corporation shall succeed the Federal Savings and Loan Insurance Corporation as conservator or receiver with respect to any institution for which the Federal Savings and Loan Insurance Corporation was appointed conservator or receiver on or before December 31, 1988. When acting as such conservator or receiver, the Corporation shall have all of the powers and rights as the Corporation has as conservator or receiver under this Act.".

SEC. 202. BRANCHING.

Section 13(k)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1823(k)(4)) is amended to read as follows:

"(4) BRANCHING PROVISIONS.—

"(A) IN GENERAL.—If a merger, consolidation, transfer, or acquisition under this subsection involves a savings association eligible for assistance and a bank or bank holding company, the resulting entity may retain and operate any existing branch or branches or any other existing facilities. If the savings association continues to exist as a separate entity, it may establish and operate new branches to the same extent as any savings association that is not affiliated with a bank holding company and the home office of which is located in the same State.

"(B) RESTRICTIONS.—

"(i) IN GENERAL.—Notwithstanding subparagraph (A), if—

"(I) a savings association described in such subparagraph does not have its home office in the State of the bank holding company bank subsidiary, and

"(II) such association does not qualify as a domestic building and loan association under section 7701(a)(19) of the Internal Revenue Code of 1986, or does not meet the asset composition test imposed by subparagraph (C) of that section on institutions seeking so to qualify,

such savings association shall be subject to the conditions upon which a bank may retain, operate, and establish branches in the State in which the Savings Association Insurance Fund member is located.

"(ii) TRANSITION PERIOD.—The Corporation, for good cause shown, may allow a savings association up to 2 years to comply with the requirements of clause (i).".

SEC. 203. REMOVAL.

Section 21A(*l*) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(*l*)) is amended to read as follows:

"(l) POWER TO REMOVE; JURISDICTION.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, any civil action, suit, or proceeding to which the Corporation, in any capacity, is a party shall be deemed to arise under the law of the United States, and the United States district courts shall have original jurisdiction over such action, suit, or proceeding. The Corporation, in any capacity, shall be an agency of the United States for the purpose of section 1345 of title 28, without regard to whether the Corporation commences the action.

"(2) CORPORATION AS PARTY.—The Corporation shall be substituted as a party in any civil action, suit, or proceeding to which its predecessor in interest was a party with respect to institutions which are subject to the management agreement dated February 7, 1989, among the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation. The Corporation shall be deemed substituted in any action, suit, or proceeding for a party upon the filing of a copy of the order appointing the Corporation as conservator or receiver for that party or the filing of such other pleading informing the court that the Corporation has been appointed as conservator or receiver for such party.

"(3) REMOVAL AND REMAND.—The Corporation may, without bond or security, remove any action, suit, or proceeding from a State court to the appropriate United States District Court, including the United States District Court for the District of Columbia. The removal of any action, suit, or proceeding shall be instituted (A) not later than 90 days after the date the Corporation is substituted as a party, or (B) not later than 30 days after service on the Corporation, if the Corporation is named as a party. The Corporation may appeal any order of remand entered by a United States District Court.".

TITLE III—TECHNICAL AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 301. TECHNICAL AMENDMENTS.

(a) FEDERAL DEPOSIT INSURANCE ACT AMENDMENTS.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended—

(1) in section 3(q)(2)(E), by striking "Depository Institutions Supervisory Act" and inserting "Financial Institutions Supervisory Act of 1966";

(2) in section 5(d)(3)(B), by striking "shall" in clauses (ii) and (iii);

(3) in section 5(e)(4), by striking the designations "(i)" and "(ii)" and inserting the designations "(A)" and "(B)", respectively;

(4) in section 7(a)(8), by striking "the the" and inserting "the";

(5) in section 7(*l*)(7), by striking "the value of";

(6) in section 7(m)(5)(A), by striking "institution" the second time it appears;

(7) in the third sentence of section 8(a)(7), by striking "the period" the first time it appears;

(8) in paragraphs (3) and (4) of section 8(b), by striking “subsection (u)” and inserting “subsections (u) and (v);

(9) in section 8(b)(6)(F), by inserting “appropriate” before “banking”;

(10) in section 8(c)(2), by striking “injuction” and inserting “injunction”;

(11) in section 8(g)(1), by striking “party,” the first time it appears and inserting “party”;

(12) in section 8(g)(2), by striking “depository institution” each time it appears and inserting “bank”.

(13) in section 8(o), by striking “board of directors” each time it appears and inserting “Board of Directors”;

(14) in section 8(r)(2), by striking “therof” and inserting “thereof”;

(15) in section 10, by redesignating subsection (e) as subsection (d);

(16) in section 11(a)(2), by striking the designation “(b)” and inserting the designation “(B)”;

(17) in section 11(c)(6)(B), by striking “Owner's” and inserting “Owners' ”;

(18) in section 11(d)(2)(B)(iii), by striking “is” and inserting “are”;

(19) in section 11(d)(8)(B)(ii), by inserting “provide” after “disallowed,”;

(20) in section 11(d)(16)(B)(iv), by striking “dispositions” and inserting “disposition”;

(21) in section 11(e)(12)(B), by striking “directors or officers” and inserting “directors' or officers' ”;

(22) in section 11(i)(3)(A), by striking “or” the last time it appears and inserting “of”;

(23) in section 11(q)(1), by striking “decided” in the second sentence and inserting “held”;

(24) in section 13(f)(6)(A), by striking “has in default” and inserting “is in default”;

(25) in section 13(i), by redesignating paragraphs (11) and (13) as paragraphs (10) and (11), respectively;

(26) in section 18(k)(4)(C)(ii), by striking “Board” and inserting “Corporation”;

(27) in section 30(e)(1)(A), by striking “venders” and inserting “vendors”;

(28) in section 31(b)(1), by striking “Board of Directors” and inserting “board of directors”; and

(29) in section 34(a)(1)(A)(iii), by striking “and” and inserting “or”.

(b) TITLE 28 AMENDMENT.—Section 1657 of title 28, United States Code is amended by inserting "section 11, 12, or 13 of the Federal Deposit Insurance Act or" after "the consideration of any action brought under".

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The **CHAIRMAN**. Thank you, Senator Garn.

Senator D'Amato?

OPENING STATEMENT OF SENATOR D'AMATO

Senator **D'AMATO**. Mr. Chairman, let me simply say that there are some very real misconceptions, as Senator Garn has indicated, in relationship to this entire issue. Everything we do is political.

But, my gosh, some things should be separated out from the political chaff that we generally have to see and let's recognize that what we're doing by failing to enact legislation that corrects and gives clarification to the present situation is going to be an incredible burden to the U.S. taxpayer.

It does not make sense.

Second, it's going to impede honest business transactions. It's going to make it impossible. We've got to resolve this.

So I think we need to pass this legislation. If there are amendments, as the Senator has indicated, that will make it better, stronger, then let's do it. We've got to do this so that we can protect the taxpayers, so we can protect the Bank Insurance Fund from superfund liability and give lenders some protection and some comfort in situations where they deserve it, on the basis of fairness and on the basis of equity and on the basis of being responsible.

We've got more people running for more offices who claim more things. Some people say, oh, this is going to preempt State law provisions with respect to private banks.

It's not true. People who are supposedly legal scholars and who represent States, and I'm talking about State's attorneys general, should know better. They shouldn't put up this red flag where there isn't one.

So let's get on with the business of doing what we have to do as far as lender liability legislation. Here's an opportunity to protect some taxpayers' money and to do what's right.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Thank you, Senator D'Amato.

[Prepared statements of Senators Dixon, Sanford, and Bryan follow:]

Alan J Dixon

JUNE 12, 1991

STATEMENT OF SENATOR ALAN J. DIXON
SENATE BANKING COMMITTEE
HEARING ON LENDER LIABILITY LEGISLATION

MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS MORNING AS THE SENATE BANKING COMMITTEE CONSIDERS THE NEED FOR LEGISLATION ON LENDER LIABILITY. MY GOOD FRIEND, SENATOR GARN, HAS INTRODUCED S. 651 AND I KNOW HE FEELS STRONGLY ABOUT THIS ISSUE.

LAST YEAR WHEN WE HELD A HEARING ON THIS ISSUE I SAID THAT WE HAVE TO BE CONCERNED, ON THE ONE HAND, ABOUT FRIGHTENING BANKS INTO CURTAILING LENDING TO SMALL BORROWERS AND BEING UNABLE TO FORECLOSE ON DELINQUENT PROPERTY AND, ON THE OTHER HAND, ABOUT INADVERTENTLY CREATING LOOPHOLES IN THE SUPERFUND ACT. I STILL BELIEVE THAT WE MUST DEAL WITH BOTH OF THOSE CONCERNS. WE NEED TO MAKE SURE THAT THE LAW SETS UP THE PROPER INCENTIVES FOR LENDERS

AND BORROWERS -- INCENTIVES TO PREVENT, STOP, AND CLEAN UP CONTAMINATION EFFICIENTLY AND FAIRLY AND TO PROMOTE ECONOMIC GROWTH.

I UNDERSTAND THAT THE ENVIRONMENTAL PROTECTION AGENCY PROPOSED A RULE ON JUNE 5TH WHICH ATTEMPTS TO PROVIDE CLARITY AND CERTAINTY TO LENDERS SO THEY WILL KNOW WHAT THEY MAY AND MAY NOT DO TO AVOID LIABILITY. IN ADDITION TO CLARIFYING THIS "SECURITY INTEREST EXEMPTION" FOR LENDERS, THE RULE ALSO DEFINES FURTHER THE "INNOCENT LANDOWNER DEFENSE" WHICH WOULD APPLY TO THE FDIC AND THE RTC.

I DO NOT YET KNOW WHETHER ALL ELEMENTS OF THE EPA RULE ARE DESIRABLE. I WILL BE INTERESTED IN ALL OUR WITNESSES VIEWS ON THIS SUBJECT AND ON WHAT PROVISIONS WOULD STILL BE NEEDED IN LEGISLATION.

OPENING STATEMENT OF SENATOR TERRY SANFORD
HEARING ON LENDER LIABILITY
JUNE 12, 1991

Thank you Mr. Chairman. I appreciate your efforts to address this important issue in this hearing today. I also want to thank Senator Garn for all of his hard work on this issue. Finally, I want to thank our witnesses for their willingness to be with us this morning. I look forward to hearing the information they will present.

Perhaps, no other government program has endured the degree of congressional oversight, public scrutiny, corporate polluter enmity and environmentalist criticism as Superfund. For all its failings, Superfund has carved a niche where nothing existed before. The liability structure established by Superfund extends beyound the 1207 sites on the National Priorities List. Under this statute, banks, thrifts, credit unions and other lenders can be found liable for environmental cleanup costs if they own or have a hand in operating a hazardous waste site. Lenders can become owners or operators in a variety of ways. The most typical involve lenders actually participating in the management of a borrower's polluting business or foreclosing on contaminated collateral.

To protect themselves from possible Superfund liability, lenders often require environmental investigations of potential loans and workouts. If contamination is discovered, the lender and borrower frequently negotiate a plan to clean it up. As foreclosure activity increases for agencies like the RTC and the FDIC, sweeping liability clauses like those found in the Superfund threaten the basic stability of the system. As exemptions arise, too much is left to the interpretation of the courts. Common practice needs to be established. A workable standard needs to be set.

It is my understanding that recently the EPA released a proposed rule that clarifies the lender liability question for banks, other private lenders, and government agencies. However, many questions remain unanswered as to similar situations outside the realm of the EPA. Lack of available credit or increased cost of credit due to the perception of extreme risks could be extremely damaging to the growth and competiveness of small business.

It is our task to determine what is effective and reasonable. Current law affects lenders, both private and Federal, that are involved in different sectors of the economy. Environmental liability should be should be reasonably shared by all.

I look forward to hearing the testimony of our fine witnesses, and learning more about this important problem.

Thank you, Mr. Chairman.

Richard Bryan

STATEMENT OF SENATOR RICHARD BRYAN

Mr. Chairman, I commend you for scheduling this hearing on S. 651, relating to lender liability. I am a strong supporter of S. 651 and urge the Committee to adopt it as part of any comprehensive banking legislation we report out.

Last week, the Environmental Protection Agency unveiled new regulations that seek to limit innocent lenders' liability for hazardous waste cleanup costs under Superfund. I applaud EPA's efforts but believe legislation is still needed to codify an "innocent lender" exemption.

American businesses are having a difficult enough time getting financing these days. The current uncertainty over lender liability has made matters worse. By enacting S. 651, we can clarify that only lenders with fault should be help accountable.

The CHAIRMAN. Let me tell you what we're going to do this morning. We have eight witnesses to speak and we want to leave time for questions and we may get interrupted by votes at some point.

I'm going to make all statements a part of the record. I'm going to ask each witness to try to summarize their thoughts in about 5 minutes, and that will give us, I think, sufficient time to move through what we must do. I expect other members to arrive later here as well.

Also, Chairman Seidman has a matter of some great importance that he must attend to a little bit later this morning. So what I'm going to do here is ask you to proceed first. And then when you finish, I think we'll take a round of questions and maybe we can then finish with you and allow you to leave, and we can then go on to the others. I don't want to inconvenience them at all, but I know you've got a special problem, so we'll try to do that if that's a workable accommodation.

So if it is, why don't you then proceed, Mr. Seidman.

STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC

Mr. SEIDMAN. Well, thank you, Mr. Chairman, for that accommodation. I appreciate it, and I appreciate the opportunity to be here with you and Senator Garn and Senator D'Amato to talk about the FDIC and the RTC's views on the environmental lender liability issues.

The CHAIRMAN. Could I get you maybe to pull the mike a little closer because we've got a full room and I want everybody in the back to be able to hear.

Mr. SEIDMAN. All right. Let me start by saying that I listened very carefully to the opening statements by Senator Garn and Senator D'Amato. I think we could say that we agree with every word that was presented by both the Senators on this issue, and that they covered a number of the issues that you raised in your opening statement, Senator Riegle. We certainly support the views that were expressed by the two Senators.

We strongly support the legislation introduced by Senator Garn. We have in the past. It would eliminate the diversion of deposit insurance funds from their primary purpose of protecting depositors.

S. 651 provides the FDIC and the RTC with immunity from liability unless we cause or contribute to the release of hazardous substances. It also protects our first subsequent purchaser, which is critical, in our view, to any attempt to market these types of properties.

However, to further enhance the ability to market properties, it may be that the committee will want to consider extending that immunity beyond the first purchaser.

More than anything else, Senator Garn's legislation would clearly define the extent of liability for lenders, the FDIC, the RTC, and other interested parties. It is the current lack of certainty which has been aggravated by recent notable court decisions that has caused problems, not only for us, but for lenders and borrowers throughout the economy.

This is not just an RTC-FDIC issue. As Senator Garn pointed out, it is an issue which affects lending throughout the economy.

Certainty is what makes markets work. Without the certainty contained in Senator Garn's bill, lenders will continue to be reluctant to lend to particular industries and particular kinds of geographic locations.

The FDIC and the RTC will be hampered in their efforts to resolve failed institutions at the lowest possible cost while achieving the maximum possible recovery.

In spite of the excellent efforts of the Environmental Protection Agency in drafting a proposed rule to provide guidance to holders of security interests regarding their potential liability under these laws, we continue to believe that the EPA rulemaking will not eliminate the uncertainty facing the lender, the FDIC and the RTC.

We certainly commend the EPA for recognizing the legitimate concerns of lenders, the FDIC and the RTC. But the EPA-proposed rules leave major issues unresolved.

It remains unclear how effective the proposed EPA rule will be in private suits. In addition, the rule may be changed following the comment period and could ultimately be challenged in court. The uncertainty could continue for a considerable period of time and frankly, with our economy in the situation it is today, every minute counts.

This will leave lenders, the FDIC and the RTC to conduct their business without guidance regarding the activities that can best avoid or limit liability.

Finally, while the EPA rule addresses liability on the part of the FDIC and the RTC for cleanup costs, it fails to protect purchasers from these organizations.

The FDIC was created to safeguard the safety and soundness of the banking system, to provide confidence to depositors, and to resolve failed financial institutions. And similarly, the RTC was created to deal with the savings and loan crisis on the same basis.

Other agencies were created to deal with the problems of environmental contamination and they could do this much more effectively and efficiently than making it a part of the FDIC and RTC task.

The FDIC supports the goals of the underlying current environmental laws. We certainly accept responsibility if we in any way contribute to pollution. However, liability for remedying environmental problems certainly should be borne by those who created them, not by the lenders, the FDIC or the RTC, who have had no part in creating the problem.

If those who are responsible for the problem are insolvent, then another insurance fund exists to pay for the contamination under the Superfund Act. That fund, and not the FDIC fund, should appropriately bear the cost of these problems.

We strongly support Senator Garn's bill. Thank you.

[The complete statement of L. William Seidman follows:]

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

ON

ENVIRONMENTAL LENDER LIABILITY

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

10:00 AM
WEDNESDAY, JUNE 12, 1991
Room 538, Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Subcommittee. We appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation and the Resolution Trust Corporation on lender liability for hazardous substance clean up costs and damages.

The FDIC and the RTC are very concerned about the potential liability of nonculpable lenders and of the FDIC and the RTC under federal, state and local environmental laws. As this Subcommittee may know, the primary federal laws that impose liability on the basis of hazardous substance contamination are the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") or, as it is commonly called, "Superfund", and the Resource Conservation and Recovery Act ("RCRA").

As the insurer for almost 15,200 operating banks and thrifts and as the receiver of failed banks and thrifts, the FDIC is anxious that the safety and soundness of the banking and thrift system not be threatened by lender liability under these laws. We are also concerned that these laws pose serious problems for the orderly and timely resolution of failed bank and thrift institutions, for minimizing taxpayer costs, and for protecting the depositors of the nation's banking system.

Thankfully, we have not yet had a bank or thrift fail simply because of Superfund liability. Instead, banks and thrifts are attempting to avoid Superfund liability by restricting loans to certain industries, requiring environmental audits at various points during the life of a loan and limiting their oversight of borrower's activities. Yet, these very actions, which are entirely responsible from a standpoint of environmental policy, are creating problems for some borrowers. A "credit problem" exists for certain industries which may involve hazardous substances or waste problems, such as gas stations, printers, dry cleaners, pest control firms, and agribusiness. In addition, lenders are limiting their oversight of borrowers in order to avoid environmental liability at a time when prudence would indicate the need for greater scrutiny from a credit quality perspective.

Because the Federal environmental laws relating to lender liability are ambiguous, lenders are uncertain about how they can safely conduct their businesses without incurring liability. Superfund imposes liability without regard to fault and with few, very narrow statutory defenses. The high stakes risk of Superfund liability coupled with the lack of statutory or regulatory guidance leaves lenders in limbo. Lenders are uncertain about how they should manage their loans. Because the only effective protection is not to lend, lenders grow increasingly conservative in their practices.

The FDIC and the RTC are also concerned about their own potential liability for hazardous substance contamination under the literal terms of Superfund. The FDIC and the RTC should not be held responsible for environmental problems we inherit from failed financial institutions. These environmental laws, as presently interpreted, pose significant risks to our goal of protecting depositors and limiting the exposure of taxpayers. We believe it is important that we not divert deposit insurance monies from their primary purpose, no matter how laudable the other goal.

It should be understood from the outset that the FDIC and the RTC do not face environmental liability risks because we created hazardous wastes or improperly disposed of these materials. Instead, we face these potential liabilities as a result of our being an involuntary "owner or operator" of properties, for however short a period of time these properties may be in our control, and because hazardous substances were released or deposited on those properties by others in the past. The FDIC and the RTC will accept liability for environmental problems that we cause directly. We will also continue to take preventive, responsive action where there is a threat to public health and safety. However, we should not be held liable for the cost of cleaning up contaminated properties that we inherit from failed financial institutions.

The FDIC and the RTC strongly support legislation introduced by Senator Garn which would limit diversion of deposit insurance funds from their primary purpose of protecting depositors, and thus limit the cost to the American taxpayer of resolving failed and failing savings and loans. It provides the kind of immunity from liability sought by the FDIC and RTC, yet does not disturb the EPA's and private party's right to recover clean up costs from those directly responsible for hazardous substance contamination.

The EPA has recently released a rule to address some of the concerns of lenders and of the FDIC and the RTC. The EPA has done a commendable job in attempting to reconcile a creditor's need to act to protect its security interest with the EPA's duty to clean up hazardous substance contamination. The proposed rule also goes a long way in recognizing and addressing the problems faced by the FDIC and the RTC when liquidating assets of failed financial institutions. Yet, as we will discuss more fully below, the FDIC and the RTC remain convinced that only Congress can fully resolve lender liability problems. As a result, notwithstanding the EPA proposed rule, we would urge Congress to enact legislation that addresses lender liability concerns. Such legislation may achieve its goals at least in part by codifying the EPA's proposed rule.

In addition to commenting further on proposed legislation and the EPA rule, our testimony will provide background on how the FDIC and the RTC may become directly involved with property which poses problems under current environmental laws. We then will address the risk to the FDIC, the RTC, and FDIC-insured lenders from potential environmental liability claims. We will discuss generally how lenders protect themselves and have responded to the risks arising under current environmental law.

OPERATIONS OF THE FDIC AND THE RTC

At the outset, it is important to understand how the FDIC and the RTC obtain real estate that may be contaminated. Pursuant to the Federal Deposit Insurance Act ("FDI Act") and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Congress has directed that the FDIC and the newly created RTC manage the resolution of failed and failing federally insured depository institutions. The FDIC and the RTC accomplish their tasks through the utilization of statutorily approved conservatorships and receiverships. In either case, the FDIC and the RTC "succeed to ... all rights, titles, powers, and privileges of the insured depository institution ... with respect to the assets of the institution." 12 U.S.C. §1821(d)(2), 12 U.S.C. §1441a(b)(5). We inherit the assets of the failed institution -- regardless of their condition.

When serving as a conservator, the FDIC and RTC are authorized to take whatever actions are necessary to restore a failing institution to good health and as may be "appropriate to carry on the business of the institution and preserve and conserve [its] assets and property...." 12 U.S.C. §1821(d)(2)(D), 12 U.S.C.§1441a(b)(5). Currently, only the RTC employs conservatorships.

When serving as receivers, the mission of the FDIC and RTC is to liquidate the assets of the failed institution for the benefit of the institution's creditors. Generally speaking, the FDIC or the RTC is the failed institution's largest creditor, since we are subrogated to the claims of the institution's depositors. As a result, our efforts as receiver to liquidate the assets of the failed institution ultimately benefit the Bank Insurance Fund or the taxpayers.

Besides holding assets in our receivership capacity, we may also hold assets from failed financial institutions in our corporate capacity. In prior years where an assuming financial institution has had an option to "put back" assets to the FDIC in connection with a purchase and assumption transaction, assets may have been put back to the FDIC in its corporate capacity. Although assets are now "put back" to the receivership, the FDIC has held some property in its corporate capacity. Because the RTC at this time does not hold assets in its corporate capacity, its liquidation activities are carried out strictly in its receivership capacity.

In each instance, the FDIC and the RTC will have involuntarily assumed responsibility for a variety of assets that may directly or indirectly implicate environmental liabilities. These include real estate owned by the former institution by virtue of its foreclosure of collateral ("owned real estate") and non-performing loans, the collateral for which may be contaminated.

Although it is the mission of both the FDIC and the RTC to resolve the institutions in their care in the most financially advantageous manner available, the current state of environmental law poses a serious threat to the success of that mission. Influential case law could render the FDIC and the RTC liable for the costly remediation of these inherited sites and make the foreclosure of valuable but environmentally impaired collateral so risky as to compel the write-off of non-performing loans. Moreover, should a court decide to reach beyond conservatorship or receivership estates to attach liability for environmental clean ups directly to the Corporations, then the taxpayer dollars that sustain the RTC's operations or the Bank

Insurance Fund that the FDIC relies upon to resolve failed banks could be increased.

THREATS TO FDIC/RTC FUNDS

So far, both the FDIC and the RTC have been fortunate since relatively few of the many of thousands of assets we control have been identified as having hazardous substance issues. The FDIC, for example, has identified 238 assets, with a total book value of about $338 million, with potential hazardous substance problems. Clean up estimates for 117 of these properties project a cost that may be more than one and one-half times the market value of the properties. However, these estimates do not include the additional expenses attributable to the lengthened holding period associated with the liquidation of such assets.[1] As for the holdings of the RTC, approximately 480 pieces of owned real estate that raise environmental concerns have been identified: 10% are landfill/dump sites; 17% have toxic or hazardous waste; 34% have asbestos; 33% have above-ground or underground storage tanks; and 6% have miscellaneous environmental problems.

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[1] The estimated average holding period for assets with real or potential hazardous substance liability is 32 months, as opposed to approximately 14 months for all loans, mortgages and owned real estate in liquidation.

While the above numbers indicate that relatively few of the assets held by the FDIC or the RTC have hazardous substance issues, these numbers underestimated the threat we face. Financial institutions continue to fail in record numbers. As more and more financial institutions fail -- including large institutions with large asset portfolios -- and as our inventory of assets continues to grow as a consequence, the magnitude of the threat increases.

The number and size of banks and thrifts that have failed since 1983 has risen steadily. At this time, the FDIC is responsible for liquidating assets from 986 failed banks and 99 failed thrifts. The FDIC presently holds in its corporate and receivership capacities a total of approximately $15.3 billion in real estate-related assets. The FDIC is also responsible for approximately $4.2 billion in real estate-related assets resulting from large assisted bank transactions.

The RTC, from its inception on August 9, 1989, to May 30, 1991, has taken control of a total of 617 insolvent thrifts with assets of about $327 billion. The RTC has sold or liquidated deposit franchises of 396 of these thrifts with 221 thrifts remaining in conservatorship. Through April 30, the RTC sold or collected 62% of the assets of resolved thrifts, with about $71 billion of their more illiquid assets in receivership yet to be sold. Sales and collections for the thrifts in conservatorship have reduced their assets to about $93 billion on April 30. Additionally, the RTC administers approximately $23.4 billion in real estate-related assets under FSLIC assistance agreements as of March 31, 1991. Given the large portfolios of assets we hold and given the potential liability associated with any major contamination site (the EPA estimates that the cost of cleaning up the average National Priorities List ("NPL") site is $25 million), the potential liability could be large.

We also expect a greater risk of liability in the future due to the higher activity level of the EPA. Currently there are about 1,200 sites on the NPL. The EPA has identified an additional 34,000 sites that are contaminated with hazardous substances that the EPA could ultimately place on the NPL. Consistent with its statutory mandate under Superfund, the EPA may be expected increasingly to use enforcement actions under Section 106 of CERCLA to force private parties to pay directly for clean up of those sites. Where the EPA expends its own funds, it is likely that litigation will continue to escalate. As a result of increased EPA litigation, private party suits for contribution are also likely to increase in volume.

So far, hazardous substance contamination has adversely affected the FDIC's balance sheet and the cost to the RTC of resolving the savings and loan crisis largely through indirect means. First, there has been the cost of performing environmental audits or reviews of the property to determine if any environmental contamination exists. Requests from potential buyers for these audits today on most property other than single family homes are commonplace. Marketing the property without an audit is getting more and more difficult which results in longer holding costs. Second, environmental contamination problems, or the threat thereof, lower the sale price of real estate or make such property completely unmarketable. Third, buyers are more and more frequently requesting indemnification from the FDIC and RTC from future liability if they purchase the property. Today's cost of these indemnities cannot be estimated. Fourth, the threat of hazardous substance problems and associated Superfund liability prompt the FDIC and the RTC, like lenders, to shun potentially contaminated property and to avoid foreclosure. Such risk-averse behavior lowers our recoveries from such assets and, ultimately, our total recoveries from receivership liquidations. To the extent that receivership liquidations fall off in recoveries or such estates are diminished by affirmative liabilities for clean up costs, these receivership estates will not be able to repay the working capital originally lent to them by the Bank Insurance Fund or from RTC appropriated funds.

The FDIC and the RTC directly bear the cost of prior contamination when a financial institution forecloses on contaminated property prior to failure, and we inherit the problem. For example, in May 1989, the FDIC was named receiver for Katy National Bank, in Katy, Texas, and acquired title to the site of a former lumberyard which the bank had foreclosed on in 1988. The site consisted of a five acre tract of land and nine buildings west of Houston, Texas. Until 1987, the lumberyard actively sold lumber and related supplies, including agricultural pesticides to both wholesale and retail customers. Specifically, the business had stored chemicals containing DDT and various other hazardous substances, which are now banned for use as pesticide components. Also, the lumberyard treated wood, on site, with liquid wood preservatives containing dioxin.

The initial appraisal of the property first alerted the FDIC to potential problems. Subsequent studies revealed substantial ground contamination that had spread to adjacent properties. These adjacent properties included the site of an elementary school, which had been operating until 1988, and an occupied mobile home park. The EPA and appropriate state agencies were notified of the problem by the FDIC.

The cost of cleaning up this property, valued originally at $250,000, and disposing of contaminated materials (only through 1992) is estimated at this time to be $432,500. In addition to the cost of actually cleaning up the property, the FDIC will bear the ongoing expense of storing the barrels of dioxin-contaminated dirt because there is currently no way to dispose of this material. The cost to store the barrels in an EPA permitted facility is $4.00 - $6.00 per barrel per day. The property has so far produced 95 barrels of hazardous waste with an anticipated total volume of up to 600 barrels. Through 1992, storage costs are estimated to be $237,500. Once all 600 barrels are off site, the annual storage cost is estimated to be $960,500. These ongoing storage costs are being borne by the Bank Insurance Fund.

An example of how the risk of Superfund liability affects us indirectly is provided by a property in which the FDIC acquired a security interest from a failed bank in Kerrville, Texas. The FDIC elected to compromise the debt for an amount much less than that owed on the loan because of substantial polychlorinated biphenyl ("PCB") and heavy metal contamination on the property which served as collateral for the note. Because the estimated cost to clean up the contaminated property exceeded the amount owed -- indeed the estimated clean up cost exceeded $1 million -- foreclosure was eliminated as a viable liquidation alternative.

As previously testified, the FDIC and the RTC are prepared to accept liability for environmental problems that we directly cause. In addition, we will continue to take preventive, responsive action where there is a threat to public health and safety. However, the imposition of additional liability creates potential problems for the successful completion of the missions of the FDIC and the RTC.

OVERVIEW OF PRESENT LENDER LIABILITY LAW

Lenders are faced with the specter of enormous liability assessments under Superfund and other federal and state statutes that deal with hazardous substances. Because of the ambiguities associated with a lender's potential liability under Superfund, lenders are uncertain of what actions on their part might subject them to liability.

CERCLA establishes a comprehensive scheme for the clean up of sites that pose an environmental risk to public health or the environment. Under CERCLA, a current owner or operator, and typically any past owner or operator, of a site is liable for clean up costs where there is a release, or threatened release, of hazardous substances to the environment. Liability for such an owner or operator is strict and joint and several. The owner or operator may be responsible for clean up costs irrespective of whether the owner or operator caused or was in any way responsible for the release of hazardous substances that must be remedied, and that the owner or operator may be ordered to pay the entire cost of a clean up even though there are other liable parties. Under CERCLA, the EPA may order a potentially liable party to clean up the site, or EPA may perform the clean up and later seek reimbursement of the costs from the parties. If a private party performs the clean up, it may also file a lawsuit against others to seek contribution from them for the cost of the clean up.

A lender can easily become liable under Superfund. If the lender forecloses on the collateral or otherwise obtains title to the borrower's property that requires a Superfund clean up, a lender may be liable as the current owner of the property. As a result, a lender -- by the single act of acquiring title to the collateral -- may be required to pay the entire cost of a Superfund clean up. A lender can try to avoid imposition of liability by acting in a manner calculated to fall within what is known as CERCLA's "secured creditor exemption". In addition, a lender may attempt to avoid liability by performing acts to qualify for the "innocent purchaser" or "innocent landowner" defense provided under CERCLA.

The secured creditor exemption exempts from liability owners of a facility that "without participating in the management" of a facility, hold "indicia of ownership primarily to protect" the security interest in the facility. Thus, a lender is not deemed to be an owner for purposes of liability under CERCLA if the lender holds a security position in a facility and it does not participate in the management of the facility.

Recent court decisions, however, have created a tremendous degree of confusion and uncertainty as to what a lender may do to protect its security interest without losing the liability exemption by participating in the management of the facility. In United States v. Fleet Factors Corp., 901 F.2d 1550 (11th

Cir. 1990), the United States Court of Appeals for the Eleventh Circuit was called upon to interpret the meaning of the phrase "without participating in management" of the facility. In denying the lender's motion for summary judgment, the Court stated that a lender need not be involved in the day-to-day operations of the borrower's business before it may be held liable. Instead, the Court stated that a secured creditor may incur Superfund liability by participating in the financial management of a facility to a degree indicating it had a capacity to influence the borrower's hazardous waste disposal decisions.

In contrast to the Eleventh Circuit's apparent "capacity to influence" test, the United States Court of Appeals for the Ninth Circuit subsequently stated in In re Bergsoe Metal Corporation, 910 F.2d 668 (9th Cir. 1990), that a lender would not be participating in the management of a facility -- thereby losing the secured creditor exemption -- unless the lender was involved in some actual management of the facility.

Given the conflicting standards stated in the Fleet Factors and the Bergsoe Metal cases, it is unclear how other circuits will interpret the secured creditor exemption. It is too early to assess how the uncertainty caused by these decisions will affect lenders in their dealings with defaulted borrowers through workouts and foreclosure proceedings. It can be argued, however, that at least some loan workout arrangements provide the lender "the capacity to influence" and thus make them potentially liable for a Superfund clean up.

In addition to the secured creditor exemption, lenders may also try to protect their position as a non-liable party by using the so-called "innocent purchaser" or "innocent landowner" defense. A lender -- or any other person -- is not liable under CERCLA if (1) it acquired the property after the hazardous substance disposal occurred; (2) it did not know, and had no reason to know, that hazardous substances were disposed at the property; and (3) that it undertook, at the time of the acquisition, "all appropriate inquiry" into the previous ownership and uses of the property consistent with good commercial or customary practices.

In reality, however, the innocent landowner defense is of little value to lenders. The lender's burden of proof for establishing this defense is very high, and courts have consistently construed this defense very narrowly. In addition, it is unclear what level of inquiry meets the standard of "all appropriate inquiry." The statute provides no guidance on this issue. This uncertainty affects the actions lenders take with respect to the foreclosure on property and makes reliance on the innocent landowner defenses very tenuous.

Another provision of the innocent landowner defense clearly demonstrates Congress' concern about the application of

Superfund to government entities. It contains a provision that addresses the situation of a government entity that acquires property by involuntary transfer. Section 101(35)(A)(ii) of CERCLA provides that liability does not attach to "a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation." The applicability of this provision to the FDIC and the RTC, however, is very unclear. It is unclear whether the FDIC and the RTC are government entities, particularly when acting in receivership or conservatorship capacities. In addition, it is not certain whether a "transfer" of property within the meaning of CERCLA has occurred when the FDIC and the RTC become a receiver or conservator of a financial institution. Finally, even if the appointment of the FDIC or the RTC as receiver or conservator is deemed to effect a "transfer", it is unclear whether such transfers are "involuntary" within the meaning of CERCLA. Given the lack of statutory, judicial, or regulatory guidance regarding the "government entity" defense, the FDIC and the RTC can only speculate regarding its applicability to each Corporation's activities.

EPA PROPOSED RULE

Last week the EPA released a proposed rule to provide guidance to holders of security interests regarding their potential liability under CERCLA. The FDIC and the RTC commend the EPA -- its rule is clear and provides valuable guidance regarding the secured creditor exemption. However, we continue to believe that EPA rulemaking will not eliminate the uncertainty facing lenders and the FDIC and RTC. Further, the EPA proposed rule leaves major concerns of the FDIC and the RTC completely unresolved.

The FDIC and the RTC believe it is essential that the courts interpret the law in a consistent manner, especially in suits brought by private parties. It remains unclear how effective the EPA rule will be in this regard. We must bear in mind that the EPA rule at this time is only a proposed rule. As a result, it could undergo many revisions before it is issued as a final rule. If it is ultimately issued as a legislative rule, as is presently proposed, the rule would provide consistency and bind private parties. Yet, issuance of the rule as a legislative rule may well be challenged. If it is, more than a year could pass before the court rules on the legality of this approach. If, on the other hand, the rule is ultimately issued as an interpretive rule, it us unclear what deference the courts will give to it. As evidenced by recent developments in municipal liability,[2] EPA's policies under CERCLA are not free from challenge or circumvention by third parties. In light of these factors, we strongly believe that a statutory clarification of Superfund liability for lenders, the FDIC and the RTC and purchasers of their properties is needed.

The EPA proposed rule also fails to address various major concerns of the FDIC and the RTC about which we have previously testified. For example, while the rule address liability on the part of the FDIC and the RTC for clean up costs, it fails to extend beyond the FDIC and RTC to protect our purchasers. As we have testified on prior occasions, we are concerned that we will not be able to market our assets absent protection for our purchasers. Any purchaser of potentially contaminated property will insist on a significant reduction in the purchase price if they are subject to potential liability for clean up costs. Both the FDIC and RTC will be forced to reduce the value of these properties significantly in order to sell them and thereby reduce the amount of money recovered from the receivership liquidations. This will in turn reduce the amount of money the receivership estates are able to repay the Bank Insurance Fund or RTC appropriated funds. As a result, transferee protection, like that contained in Senator Garn's bill, is of critical importance to us.

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[2] See, e.g., B.F.Goodrich Co. v. Murtha, 21 Chem. Waste Litig. Rep. 679, 687 (D. Conn. Jan. 7, 1991) (denying summary judgment motion filed by third-party defendant municipalities, the court ruled that municipalities can be liable under CERCLA for having "arranged" for disposal of hazardous waste, stating that "[EPA's] policy is a guide to EPA employees in administering the Superfund and reflects EPA priorities . . . . It does not limit a private party's claims."); see also Transportation Leasing Co. v. The State of California (Caltrans), 21 Chem Waste Litig. Rep. 697 (C.D. Cal. Dec. 4, 1990) (CERCLA does not preclude liability on the part of municipalities for the disposal of household waste).

Because the EPA cannot address this and other concerns of the FDIC and the RTC within the confines of rulemaking, legislation is needed. The EPA proposed rule does not affect liability under other Federal laws such as RCRA or under state "mini-CERCLAS." As stated above, it does not protect our transferees. As a result, we believe that only legislation can fully resolve all the hazardous substance liability issues of concern to the FDIC and RTC in a way that will balance the needs to protect the environment, preserve the integrity of the insurance funds and minimize the cost of resolving the savings and loan crisis.

LENDERS' RESPONSE TO THE RISKS

Lenders clearly face significant risks under current environmental laws and court rulings. Irrespective of the size of a loan, a Superfund lawsuit could result in a claim that is far in excess of a lender's net worth. Although we are not aware of any bank that has suffered a debilitating loss or failed primarily as the result of such a claim, the potential is real that a Superfund lawsuit could cause the insolvency of an insured institution.

The FDIC has issued no guidelines on lender liability as yet. However, the banking industry is generally well versed in the risks and uncertainties under the current hazardous substance laws. Lenders have attempted to control their environmental risks in a number of ways. Almost all large institutions address hazardous substance contamination and other environmental problems in their loan policies and/or procedures manuals. Smaller lenders usually deal with the environmental issues on an ad hoc basis, seeking outside advice when necessary. Before a credit decision is made, financial institutions often conduct environmental audits on potential loan customers that are involved in some way with hazardous substances. If the borrower is unable to repay the loan, many banks assess potential environmental risk before restructuring the loan or foreclosing on real estate held as collateral.

While lenders are aware of this huge environmental risk and have taken action to limit their liability, the adequacy of the preventive measures cannot be evaluated because lender responsibility under Superfund legislation remains undefined. Various court interpretations indicate that almost any current or past owner of a site containing hazardous substances could be held liable for the cost of the clean up, whether or not that owner was in any way responsible for the problem. Also, it is possible that a lender might incur liability even if it does not take possession of real property. Because the issues are still evolving, what is considered a prudent action by the lender today might become the basis for a cause of action against the lender tomorrow.

Unless the law is changed to protect nonculpable insured depository institutions and the FDIC and the RTC from this potential liability under Superfund, it is possible that the next court ruling or regulation may have an unfavorable systemic impact on banks, savings and loans, and the deposit insurance funds.

LEGISLATIVE PROPOSALS

The FDIC and the RTC strongly support legislation introduced by Senator Garn. Subtitle B of S. 651, the Asset Conservation and Deposit Insurance Protection Act of 1991, would limit diversion of deposit insurance funds from their primary purpose of protecting depositors and limit escalation of the cost of resolving failed and failing savings and loans to the American taxpayer. It substantially provides the kind of immunity from liability sought by the FDIC and the RTC. In particular, S. 651 establishes that the FDIC and the RTC shall be immune from liability unless we cause or contribute to the release of a hazardous substance.

The provision contained in S. 651 that extends the immunity granted the FDIC and the RTC to the "first subsequent purchaser" of property from us is particularly salutary. This protection for our transferees is critical to the successful completion of our mission of liquidating assets. By protecting at least our first subsequent purchaser, at least some market may exist for contaminated properties. Through this provision, it would seem that the risk of full liability is eliminated for such purchasers, so that they may quantify the risk associated with their investment. However, to further enhance our ability to market properties that may be contaminated with hazardous substances, we suggest that such immunity be extended to all of our subsequent transferees. Otherwise, it may be virtually impossible for the FDIC and the RTC to sell contaminated properties without providing enormous discounts to purchasers as well as, perhaps, indemnities.

The FDIC and the RTC also support the legislative initiative embodied in Congressman LaFalce's bill, H.R. 1450. The legislation would clarify that Congress did not intend to make lenders liable for the clean up of hazardous substance contamination for which they had no responsibility. It would also provide vitally important guidance to lenders about how they may manage loans without losing the secured creditor exemption. H.R. 1450 also addresses the important area of fiduciary and trustee liability.

Because H.R. 1450 as presently drafted does not specifically address concerns of the FDIC and the RTC, we recommend that the bill be modified to provide explicit protection to the FDIC and the RTC. However, in so doing we would urge that the bill distinguish the FDIC and the RTC from the general category of fiduciaries and lending institutions already protected under the bill. As presently drafted, it appears that H.R. 1450 would treat FDIC and RTC conservatorship and receivership estates like other estates held by fiduciaries or trustees, such that the entire FDIC and RTC conservatorship and receivership estates would be subject to claims for hazardous substance clean up costs, even beyond the value of the property. Because such claims could severely diminish FDIC and RTC recoveries from receivership or conservatorship estates, the insurance fund and the cost of the savings and loan clean up could be adversely impacted. As a result, we suggest that H.R. 1450 be amended to provide a full and complete immunity for the FDIC and the RTC, rather than simply providing us with the same protections conferred on fiduciaries and lending institutions.

Additionally, we believe that it is important that H.R. 1450's protections be extended to cover all federal, state and local statutory and common laws which deal with hazardous subatances or wastes, not just CERCLA and RCRA. Absent such an extension, the FDIC and the RTC would have virtually the same concerns and exposure to liability as they now face, inasmuch as many states have their own "mini-CERCLAs." Thus, for H.R. 1450 to be truly effective from our viewpoint, it needs to provide the FDIC and the RTC with immunity under all hazardous substance liability laws, so long as the FDIC or the RTC is not the direct cause of the problem.

Also, we suggest inclusion of language to clarify that any immunity granted the FDIC and the RTC extend to those who purchase contaminated property from the FDIC or the RTC. To ensure that properties in our hands are indeed marketable, the immunity afforded the FDIC and the RTC must be transferable to those who buy contaminated properties from us.

Finally, the FDIC and the RTC support the legislative initiative embodied in Congressman Owens' bill, H.R. 1643, entitled the Superfund Liability Clarification Act. This bill is a useful clarification of lender liability under CERCLA. The FDIC and the RTC support the bill's provisions relating to CERCLA's secured creditor exemption. For example, the bill states that secured creditors may foreclose on property and not risk being held liable as an owner of the property. H.R. 1643 provides valuable guidance to lenders, especially in the wake of *Fleet Factors*. The bill also establishes much needed standards for environmental audits on an interim basis and directs the EPA to promulgate regulations to establish permanent standards. Because such audits play a key role in the context of CERCLA liability, the definition of standards for environmental audits will be helpful. By addressing the "innocent landowner" defense, H.R. 1643 would also provide additional needed CERCLA clarification.

While appreciating the bill's extension of protections afforded "insured depository institutions" to the FDIC and the RTC, we would urge revision of the bill expressly to enlarge such protections in behalf of the FDIC and the RTC and our purchasers, for the reasons stated above. In addition, we would urge that the bill be revised to provide the FDIC and the RTC with immunity from liability under all hazardous substance laws -- federal, state and common laws -- so that it may be fully effective.

CONCLUSION

In conclusion, the FDIC and the RTC are vitally concerned with the risks posed by hazardous substance claims. The greatest risk of such claims is that they may divert deposit insurance funds, and taxpayers' money allocated to resolve the savings and loan crisis, from their intended purposes. With some minor but necessary alterations, the legislative initiatives now being considered will help ensure that these funds and monies are spent properly. They also will promote the safety and soundness of the banking and thrift system.

We believe that it is altogether appropriate and necessary to exempt the FDIC and the RTC from liability under federal and state environmental laws that deal with hazardous substances and to clarify or limit the instances when a lender can be found liable. The FDIC was created to safeguard the safety and soundness of the banking system, to provide confidence to depositors and to resolve failed financial institutions. Similarly, the RTC was created to resolve the savings and loan crisis. Other agencies were created to deal with problems of environment contamination and they can do so much more effectively and efficiently. Particularly during these times of economic difficulty, the energies and funds of the FDIC and the RTC should not be diverted from their primary missions.

The FDIC and the RTC thoroughly support the goals underlying current environmental laws. However, liability for remedying environmental problems certainly should be borne by those who created them and not by lenders, the FDIC or the RTC. If those who are responsible for the problem are insolvent, then another insurance fund exists to pay for the contamination, the "Hazardous Substance Superfund" created by Congress under CERCLA. That Fund, and not the FDIC's insurance funds, should bear the cost of environmental problems.

The FDIC and the RTC appreciate being given the opportunity to discuss this important issue with the Subcommittee. Given the mixed signals from the courts to lenders regarding Superfund liability, legislative direction is certainly needed at this time.

The **Chairman**. Thank you very much, Mr. Seidman.

I've got three questions I want to cover with you and then I'll go to my colleagues.

Senator Mack has just arrived. Senator Mack, did you have an opening comment that you wanted to make?

Senator **Mack**. Why don't I just wait until it's my turn.

The **Chairman**. Very good. What we've decided to do, we're going to just address questions to Mr. Seidman and then excuse him, as he has another matter he's got to attend to this morning.

Let me ask you, Mr. Chairman, what's the appropriate protection against environmental liability that Federal financial regulatory agencies should have in light of their statutory mandate to act in emergency or other circumstances that limit their ability to avoid risks of environmental liability?

Mr. **Seidman**. Well, we have to act, Mr. Chairman, very often in an expedited way where there really isn't time to deal with these kinds of investigations. You've all heard about the problems we have in administering this vast group of assets that we're inheriting on a daily basis in the S&L crisis.

That's why we think Senator Garn's bill is essential to our being able to operate in an efficient manner.

The **Chairman**. Can you give us an example or two of any kind of extreme situations you've run into to help make this real?

Mr. **Seidman**. We have a number of situations where—one of the common ones is the gas station situation where it turns out that a tank has leaked. Suddenly, we have a piece of property that we can't deal with without having to clean up the liability.

We, of course, were not responsible. We got the property because it was turned over to us under the savings and loan, RTC program. The only way I think that we can handle that appropriately is to deal with it under the superfund act and really, we are, if you will, innocent bystanders who were loaded with this thing.

We have another example on page 11 of our long testimony regarding a bank in Texas. That deals with a lumber yard which we foreclosed, in which we have the same kind of problem where the materials used, the pesticides used on the lumber had gotten into the ground.

Those are the kinds of things that need to be corrected. But it seems to us clear that since we had no part in that, and our job is to move these things back into the private sector as quickly as we can, that they ought to be handled under other parts of the Government's program.

The **Chairman**. Now what is your view of legislation that would allow the FDIC, the RTC, the National Credit Union Administration Board and other financial regulatory agencies that act as liquidating receivers for private lenders to recover their losses first in the liquidation of the failed lender that has benefited from the Federal Government's credit?

Mr. **Seidman**. Well, that lender preference question has been discussed at great length, Mr. Chairman, in the past. It has important effects in terms of States rights and the ability of States to set the order of creditors in a liquidation.

We have in the past supported that kind of a provision and we certainly would not oppose it. I don't think that that will remedy the problem that we have here. In many cases, the potential liability far exceeds the State involved.

But as far as that preference is concerned, we certainly would support it, keeping in mind that there are many States that feel that this is something that the States ought to be able to decide.

The CHAIRMAN. Finally, what do you think the impact is, the effect on our national economy, if the Congress does not act on lender liability legislation at this time?

Mr. SEIDMAN. Well, as I tried to say in my statement, even above our own liability, I think that is the most important issue here.

We have a credit problem in this country. We have discussed it. You've heard a great deal of testimony on it. It involves a lot of issues, of which this is a part. There is no question that the uncertainty in this area, the potential for innocent parties to be liable for large amounts of money is affecting credit in certain areas, in certain industries.

I think, as I said in my statement, that to get certainty in this area and to assure innocent parties that they are not going to be hit with liability is important as one of the aspects of dealing with the credit problems that we have in the country today.

The CHAIRMAN. Very good. Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

You've indicated this, Mr. Seidman, in your testimony, but I'd like to bring it out in the form of a question.

You do feel that although the EPA regulation is good, goes a long way, that nevertheless, we ought to put it in law so that we avoid some of the legal questions.

Mr. SEIDMAN. I do, and I think, as you suggested, Senator, there are some things in there that you may want to review in terms of adding to your legislation.

I think they've done an excellent job. But it isn't law, and we need a law.

Senator GARN. How important to the FDIC and the RTC are the provisions of my bill that preempt State law with respect to the potential liability of Federal agencies?

Mr. SEIDMAN. They are important to our getting our job done at the minimum cost, and we support them strongly.

Senator GARN. Mr. Seidman, my bill provides that Federal agencies may transfer property to one subsequent purchaser who would then be covered by the liability limitations in the bill.

How significant do you feel this provision is and would you recommend that it be retained?

Mr. SEIDMAN. We believe it is an important provision. Obviously, if the purchaser has got this potential contingent liability out there, it's going to have an important effect on the risks that he's taking, what he'll pay for properties.

And we have suggested that you even might want to extend that beyond the first purchaser.

Senator GARN. That's interesting, my bill has been considerably narrowed from last year. My initial bill gave some blanket exceptions in some cases. In response to some of the criticism, we narrowed that because we didn't think, on the other hand, it was fair to allow a bank to make a windfall profit, either, to benefit by the cleanup over and above what they were owed.

So under my bill, lenders will continue to have potential liability for any actual benefit received through a cleanup operation, capped at the fair market value of the property after cleanup.

In addition, the regulators are directed to promulgate regulations to ensure that environmental considerations will be taken into account before the loan is made.

Under the Federal Deposit Insurance Act, violations of the regulations could subject the institution or individual involved to fines up to $1 million a day.

Do you believe that these provisions are sufficient to motivate lenders to consider environmental factors when making a loan?

Mr. **SEIDMAN**. I believe they are. And I believe that we are already seeing lenders taking these potential problems into consideration. There's a whole new industry out there now which is formed around making environmental evaluations of loans. We think that's a good idea, and we support your bill in that regard.

Senator **GARN**. Well, the reason that I narrowed it is to overcome some of the criticisms from the environmental community that we are going too far, that we would benefit the institution. Somebody else pays for the cleanup, superfund or some responsible party, then they benefit from it.

The second part of that change is to say, OK, if you're negligent, we want to provide some incentives. A million dollars a day I think is a pretty good incentive to say, hey, if you're aware of something and you're participating in it, you have a responsibility to try to do something about it.

The main reason I ask that question is to indicate that we have tried to balance this bill and not have unnecessary and unfair losses to the financial community, but on the other hand, not to have them benefit and make a profit as a result of the necessary cleanup or to be negligent in not doing due diligence and finding out what's going on before they make new loans.

Interestingly enough, later on, we're going to talk about the testimony from the Fed, who apparently thinks that that is a little bit too narrow. I happen to think it's a good balance between the two.

Mr. Seidman, I don't have any other questions for you at this time.

The **CHAIRMAN**. Let me go next—I'll follow by going to Senator Wirth. Let me just go to Senator D'Amato right now.

Senator D'**AMATO**. I just have one or two quick questions.

Mr. Seidman, have you had an opportunity to estimate what the cost to the RTC or FDIC would be, absent some type of clarification of lender liability?

Mr. **SEIDMAN**. Well, we have tried to estimate how many properties we now have on hand that we've identified and——

Senator D'**AMATO**. That was my second question, how many properties did you have?

Mr. **SEIDMAN**. We have provided that in our longer testimony. I can find it for you here in a minute, if you want.

But that is only what we know about. And the great question here is all the properties that we don't know about. That we cannot estimate the liability on, although we are sure that there are a lot of other properties out there that have potential liability.

So the great cost here is the unknown. The numbers that you asked for are on page 8 of our testimony. We have about 300 pieces of property in the RTC and about 118 in the FDIC that we have identified that have these problems.

Senator D'AMATO. You have well over 400 that you've identified.

Mr. SEIDMAN. Yes.

Senator D'AMATO. And that's probably just the tip of the iceberg when you get into this thing.

Mr. SEIDMAN. It probably is, and we will find more, I'm sure, as we go along.

Senator D'AMATO. Well, Mr. Chairman, this is something that we can do in a positive nature to stem the flow of taxpayers' dollars out. And if these properties have to be cleaned, as they should be, that's why you have superfund. And indeed, that does not limit the Government from going after those people who are responsible. It certainly doesn't limit the EPA from pursuing whatever action the Federal Government may deem proper.

But to allow the situation to continue in this manner is just going to make it impossible or much more difficult for the RTC to do the job that they've been charged with.

It just doesn't make sense.

So I would hope that we would push very hard for this legislation and at the first opportunity report it out and get it onto the floor, and let's have this debate and let's not hide behind the curtain of saying that I'm for the environment.

Everyone's for the environment. We all want to clean the environment. But how do you do it in the best manner possible?

And I'd suggest that Senator Garn's legislation begins to move us in that direction.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato.

We've been joined by Senator Wirth. Senator Wirth?

Senator WIRTH. Thank you very much, Mr. Chairman. Mr. Seidman, thank you very much. Gentlemen, thank you for being here.

Mr. Seidman, I don't know if you saw accounts of Mr. Bowsher's testimony before the Banking Committee yesterday, in which he suggested to us that the RTC was going to be coming up here for, he thought, $50 to $75 billion more for next year.

Does that number fit your sense of how large a request is going to come from you?

Mr. SEIDMAN. Well, that request will be determined, Senator Wirth, by the Oversight Board after studying our numbers. We have just completed an onsite review of the values which of course determines how much loss we sustain and how much money we will need.

Those numbers, as we look at them, at least in the preliminary form now, show that the request will be in the area of the maximum number that Treasury Secretary Brady made in his last appearance before Congress. That would mean about $50 billion.

In other words, we have already had $80 billion. If you add the $50 to it, you come to $130, which was the high side of Treasury Secretary Brady's estimate.

Now, as I understand Mr. Bowsher's testimony, he estimated that it might be $5 billion more than that and could go higher.

I have no argument with the fact that it could go higher. That depends on future real estate values and how many additional S&L's fail.

We are reviewing those numbers now and will be working with the administration on that request.

Senator WIRTH. So we're now at the high side of Secretary Brady's earlier estimate.

Mr. SEIDMAN. That's correct as far as our current numbers.

Senator WIRTH. When will the Congress get the request from the administration for those numbers, get the request from the administration for that commitment of funding?

Mr. SEIDMAN. I can't really answer that. That will be in the hands of the Treasury Secretary and the Oversight Board.

We are just the peons that do the work down there on this funding.

Senator WIRTH. When do you send that package to the Oversight Board?

Mr. SEIDMAN. Well, we are discussing that with them now.

Senator WIRTH. When do you transmit that? The reason I'm asking is as follows.

I can see us getting into a situation that goes as follows, that you all send the numbers up to them. They sit around the Oversight Board for 2 months or so. They then go to the administration and they get sealed off. And they get sent up to us at the last minute. Nobody appears prepared for the fact that we've got this incredible cold bath of at least $50 billion more to explain to the American taxpayers.

I can't think of very many people up here who are going to be very eager to vote for this. They're not going to like this very much. It's very unpopular. We're going into an election. And what the administration, I would think, is going to try to do is to stick it up here at the very last minute and maybe they can have it done in the middle of the night by a voice vote, who everybody disappears and says, who me? I didn't know anything about that. It just happened.

Now I'm not sure that that's the most responsible thing for us to do. And I think that we as a committee have to consider what the other options are. I think one of the options has to include getting information from you, the Oversight Board and the Treasury Department at the earliest possible time so that we're aware of how big this is going to be and we can educate our colleagues as to how big this is going to be, so we know what this package is over here.

Then if you figure you can't get the votes for this, other than trying to do it in the middle of the night and put it on the stump and run the other direction, and that's been done up here before, rather than doing it that way and doing it publicly, which ought to be done, but then we have to figure out, Mr. Chairman, how this might get tied to something else.

Is there a must-pass piece of legislation so that this kind of a request is done in fact publicly and openly, as it ought to be?

But we'll never be able to do that, Mr. Chairman, unless we get this data up here right away.

Now if you know at this point that it's going to be at least $50 billion, I would think that we have an obligation to press the administration to move this request rapidly, and so do you. We have got to get that information up here.

Now we've played "Nickel, Nickel, Who's Got the Nickel?" over and over and over again in the last 2 years with the current Treasury Department, who have been often unwilling, and you and I have had this conversation before, unwilling to send up here what it is they want and why and so on.

But we're going to have to get that in order to be able to do this thing in a responsible way and try to avoid either putting it on the stump in the middle of the night or getting into a whole variety of political recriminations because it came up here late or the Congress didn't vote on it, they didn't send it down here, whatever.

We're going to have to belly up to this, and then it's going to get more complicated, as you know, if the Bank Insurance Fund is going to have major problems, as you've suggested, the size, in the New York Times today, and you suggest that the problem of the Bank Insurance Fund may be significantly higher as well.

We have a Banking Committee that's going to be looking at the high side of Mr. Brady's estimates for the RTC and we may have a much higher number from you in terms of the Bank Insurance Fund.

We may be looking, Mr. Chairman, at well over—I can imagine us looking at well over $100 billion that we're going to have to be making a commitment on by the first of October.

Now I think we have an obligation to press as hard as possible to the administration to get those numbers up here and to press you, to urge you to do that as well, to try to get these through this cumbersome spaghetti—I don't know if you saw the spaghetti chart that we had up here yesterday of the procedures that you have to work through. I don't envy you that at all. But to get those numbers through that spaghetti chart and up here in some final kind of a fashion.

The CHAIRMAN. I might just say that it was Chairman Seidman that first brought the spaghetti chart in here and expressed some real reservations about it at the beginning.

But, in any event, do you have a comment?

Mr. SEIDMAN. Yes, I'd like to comment, if I could.

First, at this point we'll have to take the blame for being behind. In other words, we just got these numbers in the last week. We had to send people out into all of these S&L's that we have taken over and do an onsite estimate of losses, because the only way you can really know is to go out there and to check what you have estimated before against what actually happened.

As you know, that showed that the losses were about $6 billion higher than we had estimated as we went along. But it is the same estimate we've made for the whole year when we've done a macroestimate, if you will.

But I will have to take the blame for not having those numbers sooner. We've had people out in the field because we didn't want to rely on anything except onsite examinations.

Those numbers we now have. We are working with the Oversight Board and the Treasury, and they're going over the numbers. So from here on, it's a matter of us working with them to get the numbers up here.

We certainly agree with you. We need the numbers now.

But I don't want to leave the impression that they have been sitting on the numbers. We have just gotten them to them in the last week.

Senator WIRTH. Mr. Seidman, thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wirth.

Senator Garn wanted to make a comment and then I want to call on Senator Domenici and Senator Mack.

Senator GARN. If I can just make a comment on this issue.

I certainly don't disagree with my colleague from Colorado that the sooner we can have the administration's request, the better that is.

However, I would also assure him that he should have some trust in his chairman and ranking member that there will be no middle-of-the-night, no surprises. As a matter of fact, when both the chairman and I stood on the floor for the $30 billion request, it was widely discussed even then in the record that we thought it would be at least a $50 billion request.

So the numbers may vary a little bit, but it isn't going to be a surprise to anyone about what those numbers are.

And at the time on the floor, and again yesterday, it was announced rather widely and clearly and forcefully that whatever the amount was, that neither one of us would go to the floor and ask for it and try to pass it unless there was some improvement in the operation of the RTC and some specific recommendations coming up for changes.

I specifically said yesterday that I would not go to the floor and support any request of any size unless an improvement in the operations took place, or recommendations for improvements, because 2 years was long enough, that I understood the problems of starting up an agency of this size.

But 2 years on some of the cash-flow problems and the details that were discussed yesterday with Mr. Bowsher, enough time is enough time.

So I assure my colleague from Colorado that these two Senators—there aren't going to be any surprises. There will be no voice votes. There will be no games, no gimmicks. Whatever the amount is, it will be open, it will be debated on the floor, and even if we didn't feel that way, I'll guarantee you that there's enough Senators who would, that it would not happen in that manner.

But, again, I repeat. I would say to Mr. Seidman and others that I'm not going to vote any more money unless there is some improvement in that operation. It's not pleasant, the responsibilities that the chairman and I have to go to the floor and ask for that $30 billion.

So this isn't a new statement from yesterday or today. Both of us made that on the floor very clearly. And the message isn't getting through.

And we had a long discussion yesterday. I don't want to throw out the whole agency and start over again, or 2 years from now, we would be sitting talking about the startup problems of a new agency and rearranging all the deck chairs and that and causing more problems.

So Congress shouldn't be a cause of the problem. But there are some definite changes that need to be made along the lines that Mr. Bowsher and Mr. Seidman have talked about. Many of the reservations that Mr. Seidman talked about in the initial startup, he has been proven right.

So along with the request, the major point I wanted to make is along with the request for dollars have got to come some recommendations of how that money is spent.

The CHAIRMAN. I might just say, with respect to the total dollar amounts we're looking at, and we're not quite sure when all of this will come together in terms of time because, as you say, the Oversight Board has to finally make a decision and a recommendation for funding.

But if we assume, for example, that there will be a request at some point for probably $50 billion in RTC money——

Mr. SEIDMAN. That's just to cover the losses.

The CHAIRMAN. Just to cover the losses.

Mr. SEIDMAN. There will be an additional sum for working capital.

The CHAIRMAN. There will be an additional sum for working capital.

Just in broad numbers, what might that be?

Mr. SEIDMAN. I really don't have a good number on that. It depends on how fast the collections go. But it has generally run something in excess of 100 percent of the loss number.

The CHAIRMAN. So, in other words, if we need $50 for losses, we might need another $50 for working capital, until such time as those——

Mr. SEIDMAN. Yes. That's money, of course, that we pay back out of the sale of assets. But I don't have a number on that. That's the way it's been running in the past.

The CHAIRMAN. And I'm not trying to hold you to that number, but the point I'm going to make is based on what you've just said. And that is, normally, there's something like a 1 to 1 ratio, that you need a dollar's worth of working capital for each dollar of additional projected loss.

So that looks like that might be $100 billion, $50 billion of which would come back given the selloff of assets over a period of time, if you realize full value from them.

Then if we go over to the FDIC, as I understand the numbers we're looking at there now, something like maybe $25 billion will have to be borrowed from within the Government for projected losses and probably a figure that's maybe twice that for working capital requirements associated with those losses in the FDIC for commercial banks.

Is that roughly in the ballpark of what is being thought about?

Mr. SEIDMAN. Well, Mr. Chairman, that number includes what might be necessary under the most pessimistic scenario. Right now, we don't see that we will actually have to use all that.

On the other hand, as I said yesterday in discussing the quarterly statistics, while the industry as a whole doesn't look like it's having a major problem, certain parts of it are having a major problem, which are increasing the number of dollars in our problem banks, which will increase our costs.

Our current pessimistic scenario would be using, of that $25, somewhere around $10 billion. But that only goes through 1992.

So the $25 is to cover the potential which has been forecast by CBO, OMB, and anybody else who wants to get into that game.

The CHAIRMAN. Right. Well, I understand that. And when we do the banking bill, we're going to have to address the issue, the amount of that borrowing for the FDIC to cover possible bank failures, those that you foresee and then what happens if the picture worsens.

Mr. SEIDMAN. Yes.

The CHAIRMAN. But the amount that I've heard talked about to cover the outside possibility is something like $25 billion as a line of borrowing authority for losses. Maybe only half of that would be used, but up to $25. But accompanying that would also have to be again the working capital part.

And I gather in that instance, that might be something closer to like 2 to 1.

Mr. SEIDMAN. That's right because that's the initial buildup, and it's higher at the beginning. Then as things pay off, that ratio hopefully goes down.

So we think that based on the current estimates, your estimates are approximately correct.

The CHAIRMAN. And the reason I take the time to just go over this is that if these two things are going to come together about the same point in time, maybe they're in the same legislative package, maybe they're separate. But, in any event, there are going to be financial requirements that have to be faced up to and dealt with. And if you put those two together, the commitment to have $75 billion or thereabouts available, in the worse case for the banking problem, and to have an additional $50 available for what we now foresee as, in a sense, the most likely cost on S&L additional losses, plus what you've just cited, and that's the 1 to 1 in terms of working capital also for the S&L situation, so we're talking about $175 billion in total as, in effect, a new commitment, a new financial commitment to deal with problems that are in effect out there in front of us.

Now, if the estimates are right, in the case of the S&L's, that's supposed to be the most accurate figure. In the case of the banking situation, it's to be a figure that has a cushion in it, so that if the problem worsens, it still would be contained.

But, in any event, we would be asking the country and the Congress before the end of this year to commit itself to $175 billion worth of financial effort to deal with these two problems.

And just so the record is complete, are you and I understanding one another in terms of the component parts that make up that figure?

Mr. SEIDMAN. Yes, Mr. Chairman, I would only point out that the part that's borrowed for the banks is to be repaid by the banks.

So that the taxpayer would not be being charged anything for the bank's side of this problem under the scenario that has been proposed by the administration.

The CHAIRMAN. Well, I understand that and the great hope is that the banks, over some number of years into the future, would be able to replenish the Bank Insurance Fund and pay that off.

I must tell you, frankly, I think there are a lot of questions that attach to whether or not they really will be able to do that. I certainly would hope that they would be, but that's not the same thing as money in hand. And if the problem were to worsen beyond that, we could find ourselves in a situation where they can't pay it back, in which case the money has already been spent, the taxpayers have spent it, and so, the taxpayers would be left holding the bag on that issue.

Mr. SEIDMAN. If the situation gets worse than it's currently forecast, that's entirely possible.

The CHAIRMAN. Well, I don't want to take more time on this now, but I thought it was important that we take these two side-by-side financial requirements and think about them in context because they are going to be items we've got to deal with between now and the end of the year.

And it looks to me like the dollar commitment figure is up in that range of about $175, if you add the two together and take in the working capital.

Senator WIRTH. Would the chairman yield?

The CHAIRMAN. Yes.

Senator WIRTH. Would you and Senator Garn put that in a letter to the Secretary of the Treasury or to Mr. Darman and ask them to get back to us right away with how much they think, what's their formal request going to be, so that then this committee knows how to deal with it?

We have got an enormous agenda in June and July. We're gone in August and we're here in September. Presumably, this has to be done, I think, Senator Domenici, doesn't it, by the first of the year, by the first of October?

The CHAIRMAN. Let me indicate, the Oversight Board is due in here on the 26th of this month. And so, I think that would be an appropriate time to expect them to give us——

Senator WIRTH. Could we formally ask them now to make that presentation on the 26th?

The CHAIRMAN. Certainly. I don't know if they'll have all their detailed work done by then, but I would certainly expect that they would give us the indication as to what they think they're going to need.

Senator MACK. Mr. Chairman, I wonder if we could move on to the purpose of the hearing. Frankly, I've been waiting, Senator Domenici has been waiting. I'd love to have an opportunity to——

The CHAIRMAN. Well, we're going to do that in just one second. Like everything else, there's more than one matter involved here, especially when we have a witness like Mr. Seidman.

But, in any event, I think we're about to conclude this part of the discussion, in any event. And I know you must go after you ask questions from the others here.

But we'll endeavor to try to get some indication from them. And I would think that when they come in on the 26th, that would be one of their purposes, anyway, would be to indicate what they foresee needing. And I certainly intend to ask. And so they're on notice from now that we would expect some indication from them as to what their projections are.

Mr. SEIDMAN. I will deliver your thoughts to them.

The CHAIRMAN. Very good. Senator Domenici? Senator Mack?

Senator MACK. Thank you, Mr. Chairman.

I guess the first thought that comes to my mind is a statement that has been made several times—credit is to the economy what oxygen is to the body.

You responded to some of the questions indicating that this issue of lender liability is in fact an additional constraint on credit in the economy. I am moved by the interest of my colleagues with respect to the cost of the S&L bailout and the potential problems relating to the banking community.

But I would suggest that there are some things that are going on in the economy such as lender liability, such as capital gains tax rates, which I posed the question to you at the end of last year—would a lower capital gains rate increase the value of all assets? And if the value of all assets are increased, doesn't that reduce the cost of the S&L bailout?

And the answer I believe that you gave was yes.

I would assume that we ought to be addressing this question of the availability of credit in the economy and specifically today about lender liability.

I see it as just one additional constraint on the lending institutions in this country with respect to the availability of capital. I know I'm hearing it from my constituents in the State of Florida and I would suspect that every other member of this committee is hearing from people in their State with respect to lack of capital.

So my thoughts really are not so much directed at asking you a question. You've really answered the key question from my perspective, and that is can we expand credit availability in the country if we change the lender liability problem?

Do you agree with that, Mr. Seidman?

Mr. SEIDMAN. I do agree. I think it's a very important issue.

Senator MACK. Let me raise one additional point. I did take a look at page 8 of the testimony. The figures that I see are 238 assets held by the FDIC valued at $338 million. An estimate of the cleanup for 117 of those—I assume at this point you've only had the opportunity to be able to make that kind of an estimate for 117 of them—it's estimated that the cost would be 1½ times the value of the asset.

Now it seems to me that at some point, if we don't change the present situation with respect to lender liability, that when you start to calculate the potential loss to FDIC on the banking side of this, you're going to have to increase the premium because you have now added an additional risk to the banking system. You've added an additional risk to the FDIC that you not only have to potentially cover deposits or the institution, but you're also going to have to take care of the assets that need to be cleaned up.

Is that a fair conclusion to draw?

Mr. SEIDMAN. I believe that's a fair conclusion. That's right. It will increase our costs and that means that we'll have to increase premiums.

Senator MACK. And you're supportive of the Garn legislation to make this corrective action?

Mr. **Seidman**. We are fully supportive of the Garn legislation. We think it's very important, and especially important now with the problems we're having with credit.

Senator **Mack**. And again, I didn't hear your testimony because I came in from another hearing, but I assume that the EPA ruling from your perspective doesn't go far enough.

Mr. **Seidman**. Well, it doesn't go far enough. It's a very good proposal, but it doesn't provide us with the certainty we need now. By the time that goes through, the whole process is challenged in court, and so forth, it may be 2 years before we really know what the rules are.

What we need is certainty now to allow both our institutions and lenders to provide credit. And we really can't wait for a couple of years to find out how that all works out.

Senator **Mack**. So, again, if we want to reduce the cost to the taxpayer, at least as far as the FDIC situation is concerned, we need to, A, correct the situation with respect to the availability of credit in the economy, and second, we ought to change it from the standpoint of reducing the potential liability to FDIC as a result of the cleanup costs that are associated with it.

Mr. **Seidman**. Yes, sir. I agree with that.

Senator **Mack**. OK. Thank you, Mr. Chairman. That's all I have.

The **Chairman**. Thank you. Senator Domenici?

OPENING STATEMENT OF SENATOR DOMENICI

Senator **Domenici**. Mr. Chairman, I wanted to come today to congratulate Senator Garn for introducing this legislation. I also wanted to make the point that even though we are here principally because we have a federally chartered entity, FDIC, that is bearing this liability burden which nobody ever intended to create, there are literally thousands of small banks and small businesses in the United States that are not within the purview of this legislation because they're not bankrupt yet.

We haven't taken them over. But they're suffering in exactly the same way, if not worse. At least the FDIC and the RTC have called this lender liability to our attention. At last these big Federal corporations can come to Congress for money and to raise the issue of environmental liability.

But the average Ma-and-Pa filling station and county bank can't come up here for money. And I guarantee you, Mr. Chairman, that the credit crunch is real for gas stations and dry cleaners. Banks won't loan to them because of the possible liability.

This particular interpretation by the courts of liability without fault, without knowledge, as a lender in the chain is absolutely incredible.

In fact, Mr. Chairman, there are lawsuits not only suing the bank, but suing the board of directors, individually, for the particular toxic cleanup. People are reluctant to serve on boards because of the potential liability.

By not making the loans the banks are losing a lot of money. Instead, this policy is feeding the lawyers of America, there's no doubt about that. The lawyers are coming out of the woodwork in the United States since we passed the superfund.

I wonder how many hundreds of thousands of lawyers are employed because of it.

The CHAIRMAN. There may be one or two in the room today.

Senator DOMENICI. There may be. [Laughter.]

There may be. You're probably going to have one testify here shortly, I think, in this next panel. [Laughter.]

This is the fellow that wrote the article for the Washington Post sometime ago. The gist of the article is that the law doesn't need to be changed and that the lawyers can solve the problems in court.

Sure. Lawyers will do it. Courts have been doing it now. The entrepreneurs created a new kind of insurance to take care of it. And we have lawyers to write this new type of title opinions.

Law suits, specialized title insurance, tight credit for small businesses are just drags on the economy. It's a waste of resources. I'm hopeful that we don't have to wait around for the taxpayers to be liable under this law. I hope this committee will correct the lender liability problem. I hope other committees will address the more comprehensive problem the Congress and the courts created under superfund.

I'm going to ask this EPA official a question—which one is the EPA official? Is that you? [Indicating.] [Laughter.]

How do you pronounce your name?

Mr. LUDWISZEWSKI. It's Lood-wi-che-sky, Senator, but you can certainly call me Ray.

Senator DOMENICI. Ray. [Laughter.]

Well, mine is Domenici. You can call me Pete. [Laughter.]

Mr. LUDWISZEWSKI. I think I'll stick with "Senator." [Laughter.]

Senator DOMENICI. In any event, let me ask you, has anybody over at EPA done an indepth analysis of the liability questions under the superfund and what is happening out there because of the various liability issues that have arisen?

Do you know whether that study has been done?

Mr. LUDWISZEWSKI. We continue to study superfund liability and its impact on various aspects of the economy. The issue of lender liability arose some years ago and we've now moved in this rulemaking to try to bring a greater certainty.

Senator DOMENICI. I understand. And I don't think I'm going too far afield by just asking a broader question.

Is there an evaluation, after the years that we've been funding superfund—and the reason it's relevant, the liability here stems from superfund language, Mr. Chairman.

Is there an analysis of what we are accomplishing with the dollars we are spending under superfund? Has somebody done an analysis over at the EPA?

Mr. LUDWISZEWSKI. I believe so, that we have an analysis of the outputs we are getting from superfund and what our costs are. I think we can provide you some material on that.

Senator DOMENICI. Could we have that?

Mr. LUDWISZEWSKI. Surely.

Senator DOMENICI. Would this committee be interested?

The CHAIRMAN. Well, I think, certainly if you want to request that and feel that it's useful to you, we ought to have it.

Senator DOMENICI. I'd like that. Could I have that study, please?

The CHAIRMAN. And it may be useful to the rest of us.

Senator DOMENICI. So give me everything. I want to know is, if we spend $5 billion, what did we get for it?

The CHAIRMAN. Senator Domenici, let me just ask. I want to try to—you may not have been here when I said so before, but I wanted to try to excuse Mr. Seidman because he's got another thing he's got to do. But I don't want to do that before you ask any questions of him that you may have for him.

Senator DOMENICI. I won't ask any. I'll just thank him.

Mr. Seidman, I thank you, for being forthright on this issue. There are hundreds and hundreds of small businesses in the United States, and small banks, that thank you for saying, we ought to change this law. Your opinion as a Federal official is very important because in doing that, Congress is going to change the liability rules for them, too.

We really do thank you for that.

Mr. SEIDMAN. Thank you, Senator.

The CHAIRMAN. Senator Wirth wants to ask one question for the record so that we can excuse you and let you be on your way.

Do you want to do that?

Senator WIRTH. Mr. Seidman, as you know, I have been concerned for sometime with the structure of this operation, of the Oversight Board and your board and your relationship to the FDIC and the RTC.

I would like to ask you for the record if you would comment on the legislation, the Savings and Loan Simplification Act, which I introduced, getting rid of the Oversight Board, getting full-time people as members of the Board that is operating this and really splitting the functions of the RTC away from the very onerous responsibilities of the FDIC.

I'd appreciate your response and reaction to that.

Mr. SEIDMAN. Senator, if I could, I'd like to respond to you after a couple of the meetings that I am about to leave and go to.

We are studying your bill very carefully. We are looking at the problems that we have. We are looking at the comments of the GAO with regard to operations. Clearly, we need to make improvements, and the whole structure is one of the things that we're looking at.

If you would be willing to let me off now, I will respond to that.

Senator WIRTH. So that you can understand our frustration, here we are looking at an Oversight Board of five part-time individuals, two of whom have just been named. The third is the Secretary of the Treasury, who has got a lot of other things to do. The fourth is the Secretary of Housing and Urban Development, cleaning up that mess down there. And the fifth is Alan Greenspan. Five part-time people. Part-time is probably being overly positive about the amount of time that they can spend there doing this job for $175 billion.

Mr. SEIDMAN. As you know, I made a number of suggestions when the legislation was going through. We are studying it now to see exactly what we think is the best way to deal with it at this time in this very difficult process.

Senator WIRTH. Right. Well, we have to think about it, too, and I think that becomes part of this package and part of the banking package. We have to make all of these decisions as to what goes into this bill.

Mr. SEIDMAN. I hate to get up here and get associated with big numbers the way I am, but I don't know how to get out of it. [Laughter.]

Senator WIRTH. You're so good at them. [Laughter.]

The CHAIRMAN. I'm sure you'll give us a response for Senator Wirth's questions.

Mr. SEIDMAN. We certainly will do that.

The CHAIRMAN. And I think in excusing you today at this point and getting on to the others—and I appreciate the patience—there's great interest in these topics, you've served now for a good many years and your tenure may be coming to an end here someday before long.

Mr. SEIDMAN. Definitely.

The CHAIRMAN. And I think this committee, and certainly I, value your observations and your recommendations as much as any that we get from any source.

So when these questions are put to you, they are because there's a great interest on this committee in your views as to how we might make adjustments and make changes. Senator Garn has said that. I've said it. The others have said it as well.

So we will look, we will very carefully evaluate what thoughts you have for us when you're ready to give a full response, as I'm sure you will.

Mr. SEIDMAN. Thank you very much, Senator.

The CHAIRMAN. Let us excuse you now, if I may. Mr. Kelley, let me now call on you to give us your summary comments, and then we'll go to Mr. Hill and then to our witness from the EPA.

STATEMENT OF EDWARD KELLEY, JR., BOARD OF GOVERNORS, FEDERAL RESERVE, WASHINGTON, DC

Mr. KELLEY. Thank you, Mr. Chairman, and members of the committee.

I would like to thank you for the opportunity to discuss S. 651 and issues of lender liability under CERCLA. As an initial matter, we strongly support the purposes of CERCLA. We all wish to live in a clean environment, but the costs of achieving this goal are substantial. The EPA estimates that the cleanup of the 1,200 priority sites alone may exceed $30 billion, and GAO has estimated that as many as 425,000 sites may need cleanup.

Given the potential cost, we are concerned over the effect of recent court decisions holding lenders liable for cleanup costs, and we support the objectives of S. 651 to limit lender liability for such costs. Despite an exemption in CERCLA design to shield lenders from liability, lenders are being required to police their borrowers' environmental practices and they are often ill-equipped to perform this function. Imposing affirmative liability for environmental cleanup costs on lenders will do little to prevent pollution, but it is likely to interfere with the availability of credit to even prudent businesses that use hazardous substances.

Lack of credit is likely to have a significant adverse effect on many industries or areas and to frustrate environmental interests.

Companies unable to operate because they cannot obtain credit will not be able to contribute to the cleanup costs. Consequently, imposing liability on lenders may actually frustrate the environmental goals of CERCLA and increase the cleanup cost borne by the Government.

While the Board does not have comprehensive data on lender losses due to CERCLA liability to date, Federal Reserve Bank reports suggest strongly that CERCLA liability is in fact affecting the availability of credit. Banks are developing environmental guidelines that discourage loans collateralized by property that may be contaminated by past units, or to businesses that use or produce hazardous substances, often regardless of the safety of a borrower's handling of these substances.

In addition, banks are examining property carefully before foreclosing and are sometimes walking away from collateral to avoid CERCLA liability, which will cause lenders to become increasingly cautious about future loans to many businesses or areas.

Banks have experienced difficulty in determining the appropriate practices to minimize CERCLA liability. The Board is developing guidelines for bank examiners to follow in determining whether a lending institution has appropriate procedures to recognize potential environmental problems. Unfortunately, given the current state of the law, there is no clear guidance that we can provide as to how an institution can extend credit and still avoid liability.

CERCLA also raises significant issues concerning the funding of Government operations. Unlimited CERCLA liability for federally insured institutions could result in the costs of hazardous substance removal being borne by the bank and thrift insurance funds. Further, many agencies and instrumentalities of the Federal Government, such as Federal Reserve Banks, the Farm Credit Administration, and the Small Business Administration, are also lenders.

We feel that it is not appropriate to shift the cost of environmental cleanup from the funds allocated by Congress for this purpose to the bank and thrift insurance funds or to other governmental agencies.

We believe that the appropriate avenue for remedying these problems is legislation. While we commend the EPA for its efforts to provide regulations to clarify the secured lender exemption, it is necessarily limited by the current statutory provisions. We believe that greater certainty and protection for both public and private sector lenders will be provided by statutory amendments.

S. 651 presents a viable approach to reducing potential lender liability for both the private and public sectors. However, it does not cover all lenders and leaves unanswered questions as to actions a lender must take to preserve the limitation on liability. For example, a lender would lose all benefit of the exemption if it caused or contributed to the release of hazardous wastes or failed to take steps to prevent continued release. This stringent standard juxtaposed against the severe implications of being found responsible, could be a serious inhibition to the lender's willingness to lend.

S. 651 addresses Federal banking and lending agencies by providing protection for these entities and the next purchaser of the property by excluding them from liability and exempting property held or sold by the entities from certain CERCLA liens. The Federal banking and lending agencies would also be exempted from CERCLA requirements that they warrant the cleanup of any property before it can be sold. This would improve the ability of Federal banking and lending agencies to obtain repayment of loans or realize the value of real property and would limit the extent to which their funds are diverted to pay cleanup costs. The extension of broad agency immunity to subsequent purchasers should be particularly helpful.

S. 651 also requires Federal banking agencies to write regulations requiring institutions to adopt procedures for evaluating environmental risks. We feel that the incentives already exist in this area due to CERCLA's liability and the potential loss of loans, and that those incentives are adequate to encourage lenders to evaluate environmental risks. It's unnecessary to add additional regulations.

In light of these considerations, we believe it's in the interest of the financial and environmental communities to find a balanced solution to the lender liability issue and the goals of CERCLA will be furthered rather than hindered by the provisions of S. 651.

Thank you, sir.

The CHAIRMAN. Thank you, Mr. Kelley.

Mr. Hill, we'd like to hear from you now.

[The complete statement of Edward W. Kelley, Jr., follows:]

For release on delivery
10:00 a.m. EDT
June 12, 1991

Testimony by

Edward W. Kelley, Jr.

Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

June 12, 1991

Mr. Chairman, members of the Committee, I'd like to thank you for the opportunity to discuss the issues of lender liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), as well as the solutions to this problem proposed by S. 651. The issues presented in this legislation are complex, and I commend the Committee for undertaking to explore them fully at this time.

As an initial matter, we strongly support the purposes of CERCLA. We all wish to live in a clean and healthy environment, however, the costs of achieving this goal are substantial. The Environmental Protection Agency has estimated that the cleanup of the 1200 priority sites alone may exceed $30 billion. The General Accounting Office has estimated that as many as 425,000 sites may need investigation and possibly cleanup.

In light of these potential costs, we have become concerned over the effect of recent court interpretations of CERCLA that have held lenders liable for the cost of the cleanup of hazardous substances found on a borrower's property. Despite an exemption in CERCLA designed to shield lenders from CERCLA liability, these decisions in effect place lenders in the role of policing the hazardous substance disposal activities of their borrowers. Lenders are often ill-equipped to perform this function, and imposition of unlimited liability can be expected to reduce their willingness to provide credit to prospective borrowers in any business or area where there is a risk of CERCLA liability. A reduction in the availability of credit threatens the viability of these businesses and their ability to contribute to the cleanup of the environment. Consequently, we believe that the imposition of cleanup liability on lenders is counterproductive to long term environmental goals and is contributing to an unnecessary and unwarranted constriction of credit availability to a wide range of otherwise creditworthy borrowers. We support the objectives of S. 651 to limit lender liability for cleanup costs under CERCLA.

Under CERCLA, the owner or operator of a property may be held liable for the entire cost of cleaning up hazardous substances found on a site, regardless of whether they are responsible for the release of the hazardous substance. By its terms, CERCLA generally excludes secured lenders from this liability, however, recent court decisions have largely eroded the protection furnished by this exclusion. Courts have imposed lender liability under CERCLA when a lender secured by property forecloses on property or has "participated in the management" of its borrower by virtue of the rights reserved by the lender under its lending and security agreements with the borrower. With the average projected cost of remedying contamination at sites on the National Priority List climbing to over $25 million dollars, liability in CERCLA cases may far exceed the amount of the lender's original loan.

Because of the erosion of the secured lender exemption, lenders to borrowers in businesses that use or produce hazardous substances are faced with a dilemma. Lenders can actively attempt to police hazardous substance disposal by their borrowers, risking being found to have "participated in the management" of the borrower and therefore liable for potential cleanup costs, or they can ignore the borrower's activities and risk nonpayment of the loan. Further, these court decisions may discourage even normal loan collection practices out of concern that they will be found to constitute management.

Lenders already have adequate incentives to encourage their borrowers to engage in environmentally safe practices so that these borrowers will avoid CERCLA liability. However, lenders do not generally have the technical expertise to police the environmental aspects of a borrower's operations. Covenants in borrowing agreements that give lenders a voice in their borrower's activities are designed to ensure that the borrower acts prudently in financial matters and places a high priority on the repayment of the debt, not to permit the lender to substitute its judgment for the borrower's in technical aspects of the borrower's business.

Imposing affirmative liability for environmental cleanup costs on lenders due to the exercise of such covenants is likely to do little to prevent the pollution of the environment, but is likely to interfere with the availability of credit to even prudent businesses that use hazardous substances, such as farmers, dry cleaners, service stations, and chemical and fertilizer producers. Credit is a necessity for the operation of commercial enterprises. Lenders, already reluctant to extend credit to borrowers that are subject to a high risk of CERCLA liability, will only be deterred further by the prospect of affirmative lender liability under CERCLA. Increased lender reluctance to provide funds to industries or areas that present a risk of CERCLA liability is likely to have a significant adverse effect on these industries or areas.

Lack of credit in these cases may also frustrate environmental interests. Companies that are unable to continue operating because they cannot obtain credit will not be able to make any contribution to the environmental cleanup costs. Consequently, the current thrust of court decisions imposing lender liability under CERCLA may actually frustrate the environmental goals of CERCLA and increase the cleanup costs that must be borne by the government.

While the Board does not have comprehensive data on lender losses due to CERCLA liability to date, clearly significant losses have already occurred. More important to the future is that data from the Federal Reserve Banks suggest that CERCLA liability is in fact affecting the availability of credit. Banks are developing environmental guidelines that often indicate that the lender should decline to make loans collateralized by real property where past uses may have resulted in contamination of the property or to make loans to businesses that may use or produce hazardous substances in their operations. In some cases it appears that banks are declining to make loans regardless of the safety of a borrower's handling of hazardous substances.

In addition, banks are examining property carefully before they foreclose on it, and are sometimes walking away from their collateral in order to avoid environmental liability. This problem appears to be widespread, and is not confined to industrial areas of the country or to particular types of businesses. Virtually every Federal Reserve Bank reported instances where lenders had walked away from collateral, even where the collateral was the only source of repayment for the loan. The experience of walking away from collateral to avoid CERCLA liability is likely to cause lenders to become increasingly cautious about loans to many businesses or areas, even if no actual liability has been incurred under CERCLA.

In carrying out its examination and supervisory activities, the Federal Reserve expects banking organizations to have policies and procedures in place to monitor and control the risks to which banking organizations are exposed. However, banks have experienced difficulty in determining the appropriate protective practices to minimize the potential for CERCLA liability. Lending institutions are at risk for hazardous waste liability whether they have ignored hazardous waste issues altogether or have actively attempted to monitor the safety of their borrowers' operations. The Board currently is developing guidelines for bank examiners to follow in determining whether a lending institution has adopted appropriate procedures and safeguards to recognize potential hazardous substances problems. Unfortunately, given the current state of the law, there is no clear guidance that we can provide as to how an institution can extend credit and still avoid liability.

In addition to private sector liability, CERCLA raises significant issues concerning the funding of government operations. Many lending institutions that are potentially subject to CERCLA liability are federally insured through the bank and thrift insurance funds. Unlimited liability under CERCLA poses a potential threat to the capital and solvency of these institutions, and in some cases could result in the costs of hazardous substance removal being borne by the bank and thrift insurance funds. We understand that the FDIC has already incurred losses as a result of CERCLA.

Further, many agencies and instrumentalities of the federal government, such as Federal Reserve Banks, Federal Home Loan Banks, the Farm Credit System and the Small Business Administration, are also lenders. Lender liability presents a threat to the ability of these organizations to carry out the missions assigned to them by Congress. The Federal Reserve Banks fulfill important functions in providing adjustment credit and acting as a lender of last resort for depository institutions. In acting as lender of last resort, a Federal Reserve Bank may advance funds to a depository institution collateralized by the institution's loans, which may in turn be secured by real property. Should the institution fail, the FDIC, as receiver, would likely acquire the loans from the Reserve Bank and would be left holding the loans. In these cases, the FDIC would be exposed to lender liability to the same extent as the original lender. If the FDIC chose not to acquire the loans, however, the Reserve Bank would be subject to this exposure.

It is not appropriate to shift the risks and expenses of environmental clean up costs from the funds allocated by Congress for this purpose to the bank and thrift insurance funds or to governmental instrumentalities such as the Federal Reserve Banks. Federal agencies and instrumentalities have been charged by Congress with particular responsibilities. Their funds are intended to be used to fulfill these responsibilities, not to cover the costs of hazardous substance removal.

We believe that the appropriate avenue for remedying these problems is legislation. While we commend the Environmental Protection Agency for its efforts to provide regulations to clarify the secured lender exemption, its efforts are necessarily limited by the current statutory provisions. We believe that greater certainty and protection for both public and private sector lenders will be provided by statutory amendments.

Any legislation to limit the application of CERCLA liability should apply to all lenders and should strive to delineate clearly those activities that will lead to CERCLA liability. S. 651 presents a viable approach to reducing potential lender liability problems under CERCLA for both the private and public sectors. While this bill has a number of strong points, it does not cover all lenders and leaves unanswered questions as to what duties, if any, those lenders that are covered must perform in order to preserve the limitation on liability.

S. 651 amends the Federal Deposit Insurance Act to limit the liability of mortgage lenders and federally insured depository institutions for the cost of hazardous substance removal. It appears that the liability of these lenders would be limited to the amount of the loan made by the lender or the actual benefit received by the lender from the cleanup of the property. S. 651 also provides that mortgage lenders or insured depository institutions will not be liable for cleanup costs based on their unexercised capacity to influence the operations of a borrower.

However, under S. 651 a lender would lose all benefit of the exemption if it caused or contributed to the release of hazardous wastes or failed to take reasonable steps to prevent continued release. It is not clear under what circumstances a lender would be considered to have caused or contributed to a release, or what actions a lender must take to prevent a release. This stringent standard juxtaposed against the severe implications of being found responsible could be a serious inhibition to a lender's willingness to lend.

S.651 also specifically addresses the concerns of Federal banking and lending agencies by providing protection for these entities and the next purchaser of the property by excluding them from liability for hazardous substance removal and exempting property held or sold by these agencies from certain CERCLA liens. The Federal banking and lending agencies would also be exempted from CERCLA provisions requiring federal government entities that are owners or operators of facilities to provide warranties concerning the cleanup of any property before it can be sold.

These provisions would improve the ability of the Federal banking and lending agencies to obtain repayment of their loans or realize the value of real property and would limit the extent to which their funds are diverted to pay for hazardous substance cleanup costs. The extension of the broader agency immunity to subsequent purchasers should be particularly helpful in this regard by encouraging prospective purchasers to invest in properties that carry a risk of CERCLA liability.

S. 651 also requires the Federal bank regulatory agencies to promulgate regulations to require the institutions they supervise to adopt procedures for evaluating environmental risks associated with lending secured by property. We believe that the incentives arising from the risk that the borrower will be unable to repay its loan due to its own CERCLA liability are adequate to encourage lenders to evaluate environmental risks related to their borrower's property. Banks are already beginning to undertake these evaluations. Accordingly, we do not believe that it is necessary to add additional regulatory requirements in this area.

In closing, it is in the interests of the financial and environmental communities to find a balanced solution to the lender liability issue. If this issue is not resolved, we risk a reduction in the availability of credit to any industry, area, or borrower that appears to present a risk of liability for hazardous substance removal. We also risk imposing additional costs on the bank and thrift insurance funds to pay for environmental cleanup costs that would otherwise be met from the funds allocated by Congress for that purpose. In light of these considerations, we believe that the environmental goals of CERCLA will be furthered rather than hampered by the provisions of S. 651.

STATEMENT OF J. FRENCH HILL, DEPUTY ASSISTANT SECRETARY FOR CORPORATE FINANCE, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. HILL. Mr. Chairman, I'm pleased to appear before you today on behalf of the Department of the Treasury and the administration to discuss what has commonly become known as lender liability under CERCLA.

I might add as a personal note, that I'm also pleased to be here having served on the staff of this committee during the early 1980's, under the leadership of Senator Garn and Senator Proxmire.

Legislation has been introduced in the Congress that seeks to resolve the lender liability issue, including S. 651, introduced by Senator Garn, and H.R. 1450, introduced by Mr. LaFalce in the House. These bills have been instrumental in focusing the debate on the lender liability problems facing our country.

The administration supports the lender liability objectives of these bills and believes that the rule released by EPA last week achieves all of those objectives with precision and clarity.

We support EPA's rule because it provides bright-line certainty for lenders—I might add, both private and public—so they might avoid liability when extending credit.

With respect to the CERCLA security interest exemption, if the Congress believes that legislative action is appropriate, the administration will support legislation to the extent that it enacts the provisions contained in the proposed EPA rule.

We are aware that the committee is concerned that the EPA rule may not effectively bind third-party plaintiffs who may bring suit under CERCLA. This issue is addressed in both S. 651 and H.R. 1450.

It's the position of the administration that the EPA rule, which is a legislative rule, has the force and effect of law and will bind third-party actions.

Both bills would clarify the security interest exemption with respect to both CERCLA and the Resource Conservation and Recovery Act—RCRA—of 1976. Although the EPA rule only clarifies lender liability in the context of CERCLA, the administration is aware that there may be a similar issue with respect to liability of lenders under the underground storage tank provisions of RCRA. The administration believes that the secured creditor provisions of RCRA, the Resource Conservation and Recovery Act, should be similarly interpreted and applied.

We're also aware that there are a number of other issues of concern to the committee that could not be addressed by the EPA rulemaking because they involve matters outside the statutory scope of CERCLA.

For example, Senator Garn's bill contains two provisions intended to make it easier for the FDIC and the RTC to dispose of property they acquire when acting as conservators or receivers of failed depository institutions.

The first would provide that the initial purchaser of contaminated property from the FDIC or RTC would be immune from strict liability under CERCLA as an owner or operator. The administration would support such a provision because it would save taxpayer money by facilitating the disposition of property held by the FDIC and RTC, provided that it is also consistent with our environmental objectives.

We believe such a provision would be consistent with our environmental objectives if it conditioned initial purchaser immunity on a commitment by the purchaser to clean up the property consistent with the national contingency plan and makes it clear that the purchaser would remain fully liable for any action it takes that threatens or causes the release of hazardous substances.

The second provision in S. 651 would exempt Federal banking and lending agencies from CERCLA section 120(h) the covenant requirements, when they dispose of property acquired in connection with a conservatorship or receivership through foreclosure on a loan or guarantee, or in civil, criminal law enforcement actions.

This issue is not new to the administration and has been the subject of an EPA regulation. The administration firmly believes that all Federal agencies should be fully subject to the covenant requirements with respect to property owned in a proprietary capacity.

We also believe that such requirements should not apply to property acquired in the manner described in S. 651, or to property acquired by any agency and held in temporary custodial capacity for subsequent sale.

The EPA rule achieves this result in the context of a security interest exemption because a securityholder who satisfies the exemption is not an owner for purposes of CERCLA and would, therefore, not be subject to the requirements of section 120(h).

The administration believes that further clarification of section 120(h) obligations for Government entities that are innocent landowners under superfund can be accomplished administratively, but would not object to appropriate legislative clarification.

Similarly, both S. 651 and H.R. 1450 seek to provide some degree of protection from liability for persons who acquire property in a fiduciary capacity.

We believe that such persons are similarly situated to holders of security interests and that they should be treated accordingly.

S. 651 would provide equal treatment of Federal and State entities and States under CERCLA. Again, to the extent such provisions are consistent with our environmental objectives, the administration would support equal treatment of State and Federal entities.

Turning back to last week's proposed rule, it is important to emphasize at the outset that the issues involved in lender liability affect more than private lenders. Senator Garn's bill reorganizes this issue. The administration is also concerned about, aside from the FDIC and RTC, all Federal agencies that lend funds, guarantee or insure loans—such as the SBA, Farmer's Home, and Ginnie Mae—and all Federal agencies that acquire security interest in the course of carrying out their statutory functions, such as through seizure and forefeiture of assets of drug traffickers.

I'd be happy to answer the committee's questions.

The **Chairman**. Very good. Thank you.

Let's go now to the EPA.

[The complete statement of J. French Hill follows:]

STATEMENT OF J. FRENCH HILL
DEPUTY ASSISTANT SECRETARY (CORPORATE FINANCE)
DEPARTMENT OF THE TREASURY

BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

JUNE 12, 1991

Mr. Chairman, I am pleased to appear before you today on behalf of the Department of the Treasury and the Administration to discuss what has commonly become known as "lender liability" under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

Legislation has been introduced in the Congress that seeks to resolve the lender liability issue, including S. 651, introduced by Senator Garn, and H.R. 1450, introduced by Mr. LaFalce. These bills have been instrumental in focusing the debate on the lender liability problem. The Administration supports the lender liability objectives of these bills, and believes that the rule released by EPA last week achieves all of those objectives with precision and clarity. We support EPA's rule because it provides bright-line certainty for lenders seeking to avoid liability when extending credit. With respect to the CERCLA security interest exemption, if the Congress believes that legislative action is appropriate, the Administration will support legislation to the extent it enacts the provisions contained in the proposed EPA rule.

We are aware that the Committee is concerned that the EPA rule may not effectively bind third-party plaintiffs who may bring suit under CERCLA. This issue is addressed in both S. 651 and H.R. 1450. It is the position of the Administration that the EPA rule, which is a legislative rule, has the force and effect of law and will bind third-party actions.

Both bills also would clarify the security interest exemption with respect to both CERCLA and the Resource Conservation and Recovery Act of 1976 (RCRA). Although the EPA rule only clarifies lender liability in the context of CERCLA, the Administration is aware that there may be a similar issue with respect to liability of lenders under the underground storage tank provisions of RCRA. The Administration believes that the secured creditor provisions of RCRA should be similarly interpreted and applied.

We also are aware that there are a number of other issues of concern to the Committee that could not be addressed by the EPA rulemaking because they involve matters outside the statutory scope of CERCLA. For example, S. 651 contains two provisions intended to make it easier for the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC) to dispose of property they acquire when acting as conservators or receivers of failed depository institutions. The first would provide that the initial purchaser of contaminated property from the FDIC or RTC would be immune from strict liability under

CERCLA as an owner or operator. The Administration would support such a provision because it would save taxpayer money by facilitating the disposition of property held by the FDIC and RTC, provided that it also is consistent with our environmental objectives. We believe such a provision would be consistent with our environmental objectives if it conditions initial purchaser immunity on a commitment by the purchaser to clean up the property consistent with the national contingency plan and makes it clear that the purchaser would remain fully liable for any action it takes that threatens or causes the release of hazardous substances.

The second would exempt Federal banking and lending agencies from the CERCLA section 120(h) covenant requirements when they dispose of property acquired in connection with a conservatorship or receivership, through foreclosure on a loan or guarantee, or in civil or criminal law enforcement actions. This issue is not new to the Administration, and has been the subject of an EPA regulation. The Administration firmly believes that all Federal agencies should be fully subject to the covenant requirements with respect to property owned in a proprietary capacity. We also believe that such requirements should not apply to property acquired in the manner described in S. 651 or to property acquired by any agency and held in a temporary custodial capacity for subsequent sale or other disposition.

The EPA rule achieves this result in the context of the security interest exemption because a security holder who satisfies the exemption is not an "owner" for purposes of CERCLA and would therefore not be subject to the requirements of section 120(h). The Administration believes that further clarification of the section 120(h) obligations for Government entities that are innocent landowners under CERCLA can be accomplished administratively, but would not object to appropriate legislative clarification.

Similarly, both S. 651 and H.R. 1450 seek to provide some degree of protection from liability for persons who acquire property in a fiduciary capacity. We believe that such persons are similarly situated to holders of security interests, and that they should be treated accordingly. For example, we do not believe that a trustee in bankruptcy or an executor or administrator of a decedent's estate should be personally subject to strict liability under CERCLA and that any environmental liability of the estate should be limited to the assets of the estate. However, we are concerned that an otherwise culpable person might be able to invoke the guise of a fiduciary to escape liability. For this reason, any legislative provision to protect fiduciaries must be carefully crafted. Finally, consistent with our environmental objectives, the provision must make it clear that a fiduciary is liable for any action it takes that threatens or causes the release of hazardous substances.

Similarly, S. 651 would provide equal treatment of Federal entities and States under CERCLA. Again, to the extent that such provisions are consistent with our environmental objectives, the Administration would support equal treatment of States and Federal entities.

Turning back to lender liability, which is the subject of last week's EPA proposed rule, it is important to emphasize at the outset that the issues involved in "lender liability" affect more than private lenders, such as banks and other financial institutions, although they are certainly the most obviously affected. The same issues are of critical concern to --

- the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC) when they become conservators or receivers of troubled or failed depository institutions;
- all Federal agencies that lend funds, guarantee or insure loans, or guarantee mortgage-backed securities, such as the Farmers Home Administration (FmHA), the Small Business Administration (SBA), the Department of Energy, the Department of Veterans Affairs, the Department of Housing and Urban Development, and the Government National Mortgage Association (GNMA);
- all Federal agencies that acquire security interests in the course of carrying out their statutory functions, such as through the seizure and forfeiture of assets of drug traffickers; and
- non-lending Federal agencies such as the Internal Revenue Service, which can acquire property through a lien for delinquent taxes, and the U.S. Customs Service which can acquire liens on vessels by operation of law.

In general, CERCLA imposes strict liability on owners and operators of property for the release or threatened release of hazardous substances. When it enacted CERCLA in 1980, the Congress made special provisions to exempt from this strict liability persons who, without participating in the management of a borrower's business, hold indicia of ownership, such as a deed of trust or mortgage, to protect a security interest. The intention of the exemption is that a lender who holds title to property primarily to protect a security interest (a mortgage is the typical example) is exempt from strict liability, even if the lender is forced to acquire the property by foreclosure. The Administration strongly supports this rational and commercially necessary exemption from liability.

Underlying the lender liability issue is the extent to which CERCLA contemplates that bankers and other lenders are to assume the role in our society of insuring or guaranteeing the environmental purity of borrowers. We find nothing in CERCLA to support such a contention. Neither CERCLA nor EPA's rule imposes any requirement that lenders conduct environmental audits or inspections prior to lending funds, or any requirement that they ensure that their borrowers act consistent with environmental laws or regulations. Instead, the security interest exemption only demands that lenders refrain from participating in the management of a borrower's enterprise when holding indicia of ownership to protect a security interest.

However, as a result of a few recent court decisions, there is now uncertainty regarding the scope of the security interest exemption. Banks and other lenders do not know when, in the course of ordinary dealings with a borrower, they may be deemed to participate in the management of a borrower's business and therefore incur strict liability under CERCLA. This uncertainty places an invisible barrier between lender and borrower and is generally destabilizing to the banking system because it discourages the conduct of normal business relationships, particularly when a borrower is having financial troubles. Similarly, lenders do not know what actions taken to protect a security interest -- such as foreclosure -- will void the exemption.

Because there are instances where lenders have been held strictly liable under CERCLA, we believe there has been an overall chilling effect on both commercial and industrial and real estate lending. Many lenders are simply not making loans to borrowers whose businesses involve hazardous substances or whose properties may have been associated with hazardous substances under a prior ownership. Moreover, many lenders are walking away from their secured collateral and not foreclosing on bad loans for fear of environmental liability, thereby incurring losses that weaken the banking system. Lenders are also refusing to extend additional credit to troubled borrowers, which can result in bankruptcy and layoffs.

If we allow this situation to continue, we believe there are potentially serious consequences for our economy, the Federal deposit insurance funds, and our efforts to clean up the environment.

We believe that lender uncertainty over CERCLA liability is exacerbating the "credit crunch" and may well jeopardize our economic recovery and growth. To the extent Federally insured depository institutions incur strict liability under CERCLA, that liability poses a serious threat to the Federal deposit insurance funds and all taxpayers. The cost of a CERCLA cleanup and attendant liability could erode minimum capital levels and force an institution into Federal conservatorship or receivership at a significant cost to the Federal deposit insurance funds.

To the extent that Federal lending agencies continue to be exposed to strict liability under CERCLA merely because they are carrying out their statutory mandates, those programs will be curtailed as funds intended for loans are diverted to pay CERCLA liability, and as agencies limit program operations for fear of incurring liability.

If Federal law enforcement agencies continue to be exposed to strict liability under CERCLA merely because they seize and forfeit property of persons who violate the law, critical tools will be eliminated from our law enforcement arsenal.

Finally, exposing lenders to the risk of strict CERCLA liability merely because they extend credit simply is not consistent with sound environmental policy. Instead of fostering a climate in which the lending community is a willing partner in our national efforts to clean up the environment by loaning the necessary funds, the uncertainty of lender liability is denying financial resources to those businesses and geographic areas that need them the most.

The Administration is committed to providing private and governmental lenders, other holders of security interests, and the FDIC and RTC with clear and unambiguous certainty concerning their potential liability under CERCLA. Resolving the lender liability issue will benefit lenders, Federal agencies, the economy and the environment.

Since last fall, the Departments of Treasury and Justice, many other Federal agencies, and the President's Council on Competitiveness, have been working with EPA to develop a rule that would resolve the lender liability problem. This has been difficult task in view of the legitimate competing policy interests involved. We are pleased that EPA has been able to develop a rule that provides the certainty needed by lenders, properly protects Federal agencies, and maintains effective protection of the environment.

The rule provides unambiguous guidance to private and Governmental lenders and holders of security interests as to how they may avoid strict liability under CERCLA. However, because clarification of the CERCLA security interest exemption alone was insufficient to protect the FDIC, RTC and other Government-appointed conservators and receivers of failed depository institutions from unwarranted CERCLA liability, the EPA rule also provides that the acquisition of conservatorship and receivership assets constitutes an involuntary transfer under CERCLA. The effect of the rule is to address the three classes of assets of a failed depository institution that can be acquired by Government-appointed conservators and receivers:

- Loan Portfolio. With respect to performing and problem loans where the collateral is in the possession of the borrower, Government-appointed conservator or receiver is a successor-in-interest entitled to fully assert the protections accorded holders in the rule.

- Property Previously Foreclosed. With respect to property foreclosed upon by a depository institution prior to the appointment of a conservator or receiver, if the depository institution is entitled to the security interest exemption, the Government-appointed conservator or receiver is again a successor-in-interest security holder fully protected by the exemption.

  Even if the depository institution may not be entitled to the security interest exemption (e.g., it impermissibly participated in its management), the EPA rule deems the Government-appointed conservator or receiver to have acquired the property through an involuntary transfer for purposes of the defense to liability available under CERCLA section 101(35).

- Investment and Other Proprietary Property. With respect to such property, the rule deems the Government-appointed conservator or receiver to have acquired the property through an involuntary transfer under section 101(35).

The EPA proposed rule released last week embodies the following principles:

PRIVATE AND GOVERNMENTAL LENDERS AND HOLDERS OF SECURITY INTERESTS

- PRE-LOAN ACTIVITIES. Strict liability under CERCLA cannot result from any action taken prior to the creation of a security interest.

  This principle is critical to lender liability because it permits lenders, without fear of CERCLA liability, to conduct environmental inspections and audits, and to condition a loan upon necessary corrective action by a borrower.

- PARTICIPATION IN MANAGEMENT WHILE BORROWER IN POSSESSION OF COLLATERAL. Strict liability under CERCLA cannot result while the borrower is in possession of the collateral unless the holder of the security interest participates in the management of the borrower's affairs by either --

  - exercising actual decisionmaking control over the borrower's environmental compliance, such that the holder has undertaken responsibility for the borrower's waste disposal or hazardous substance handling practices which results in a release or threatened release, or

  - exercising control at a management level encompassing the borrower's environmental compliance responsibilities comparable to that of a manager of the borrower's enterprise, such that the security holder has assumed or manifested responsibility for the management of the enterprise by establishing, implementing and maintaining the policies and procedures encompassing the day-to-day environmental decisionmaking of the borrower's enterprise.

  This principle (1) encourages the maximum amount of cooperation between lenders and borrowers, (2) ensures that ordinary and customary dealings between lenders and borrowers do not result in strict liability under CERCLA, and (3) clarifies that CERCLA strict liability does not arise if a lender provides financial advice and other services in areas totally unrelated to environmental compliance.

- POST-FORECLOSURE PROTECTION OF THE SECURITY INTEREST.

  A foreclosing security holder is deemed to be acting to protect the security interest and therefore not subject to CERCLA strict liability unless it is shown that the security holder has held the property for any other purposes as evidenced by --

  - a failure to offer the property for sale or to otherwise seek to divest his interest in the property, or
  - a rejection of a bona fide written offer of fair consideration from a qualified purchaser.

  This principle recognizes that lenders are ordinarily not in the business of investing in foreclosed collateral -- they are in the business of making loans. In fact, the law prohibits national banks from holding real property for investment purposes, and provides that they may hold foreclosed property for up to 10 years if that is necessary to recover on a bad loan (see 12 U.S.C. 29). For this reason, the rule provides that a foreclosing lender will be protected from CERCLA liability as long as it continues to protect the security by making a good faith effort to sell or otherwise divest foreclosed collateral for fair consideration.

  This principle also furthers two legitimate policy objectives:

  - It protects the real estate market by ensuring that lenders are not forced to "dump" foreclosed properties in times of weak markets thereby further depressing real estate values.
  - It avoids forcing lenders to wind down an ongoing enterprise -- a shopping center or a factory for example -- to avoid CERCLA liability. Not only may winding down operations reduce the value of the collateral and make it more difficult to sell, but it also eliminates jobs, reduces the tax base of State and local governments, and increases government unemployment compensation costs.

- BURDEN OF PROOF. The burden should be on the plaintiff seeking to impose strict liability on a security holder to prove --

  - that a holder participated in management (as defined above) while the borrower was in possession of the collateral, or

- that a foreclosing holder has not acted to protect the security interest (as defined above).

GOVERNMENT-APPOINTED CONSERVATORS AND RECEIVERS

- Government-appointed conservators and receivers (including the FDIC and the RTC) are entitled to assert the security interest exemption with respect to the loan portfolios (including already foreclosed upon properties) of troubled or failed depository institutions.
- Government-appointed conservators and receivers are deemed to involuntarily acquire the assets of troubled or failed depository institutions and therefore have a defense to CERCLA liability under section 101(35).
- To the extent liability attaches to property in a Government conservatorship or receivership, liability of the Government-appointed conservator or receiver shall not exceed the market value of the property less the amount of the security interest.

These principles protect the Federal deposit insurance funds from becoming a deep-pocket, either directly or indirectly, for CERCLA liability.

Finally, the Administration also is seriously concerned about another problem unrelated to the question of lender liability, which is addressed partially by S. 651 and not addressed by H.R. 1450. This concerns the potential CERCLA liability attaching to acquisitions of property of Federal agencies that are "involuntary" in nature but not in the context of Government-appointed conservatorship or receivership.

Many Federal agencies, particularly the law enforcement agencies of the Departments of Justice and Treasury that seize and compel forfeiture of property need assurances that such actions will not subject them to CERCLA liability. The same is true with respect to specific property the acquisition of which is required by an Act of Congress, or is incidental to the enforcement of a civil, administrative or criminal fine or penalty. The Administration strongly supports the proposed language in the EPA rule that would provide protection in the context of seizures and forfeitures, and is prepared to extend this principle to other involuntary acquisitions of property by Federal entities where appropriate.

This concludes my formal remarks, and I would be pleased to answer any questions you and the Committee may have.

STATEMENT OF RAY LUDWISZEWSKI, ACTING ASSISTANT ADMINISTRATOR FOR ENFORCEMENT, ENVIRONMENTAL PROTECTION AGENCY, WASHINGTON, DC

Mr. **Ludwiszewski**. Thank you.

Good morning, Mr. Chairman, and members of the committee.

The **Chairman**. Pull that a little closer, would you, so they can hear you in the back of the room?

Mr. **Ludwiszewski**. Sure.

The **Chairman**. Thank you.

Mr. **Ludwiszewski**. Good morning, Mr. Chairman, and members of the committee. I am Raymond B. Ludwiszewski, Acting Assistant Administrator for Enforcement at the Environmental Protection Agency.

Thank you for the opportunity to be here today to discuss the liability of lending institutions and various Federal financial institutions under the superfund law.

In general, superfund imposes strict liability on owners and operators of property for the release or threatened release of hazardous substances.

Section 101(20)(a) of superfund excludes from the definition of owner or operator those persons who hold indicia of ownership primarily to protect a security interest, provided that those persons do not participate in the management of the facility securing the loan.

Recent judicial decisions have created a lack of clarity concerning the scope of the superfund security interest exemption. Banks and other lenders are not certain when in the course of ordinary dealings with a borrower they may be deemed to participate in the management of a borrower's business and thereby void the exemption.

This uncertainty over potential CERCLA liability may affect the availability of credit and interfere with normal business relationships between lenders and borrowers.

Last year, my predecessor, James Strock, on behalf of the administration, committed to propose a rule that would provide private and governmental lenders and holders of security interests with greater certainty concerning their potential liability under CERCLA.

I am pleased to report to you that EPA has completed this effort. A proposed rule is now publicly available that defines when lenders are protected from liability.

In particular, EPA's proposed rule specifies when lenders cross the line from their typical creditor status and become liable because they have participated in the management of the facility. The proposed rule is currently being readied for publication in the Federal Register.

The administration is confident that the proposed rule, which is the result of a unique cooperative effort between EPA, the Department of the Treasury, the Department of Justice, the White House Council on Competitiveness, provides the needed measure of certainty where court decisions may have engendered confusion.

We are also confident that the proposed rule will provide clear guidance for the lending community so that they may responsibly manage their loan portfolios without undue fear of environmental liability.

In addition to clarifying the rules of liability for the private lending community, the proposed rule addresses the liability concerns faced by Government lending and financial regulatory entities as well as the FDIC and the RTC. Governmental entities that acquire assets involuntarily in their capacity as conservator or receiver may acquire some assets to which the security interest provisions of EPA's rule will apply.

In such cases, the governmental entity generally stands in the shoes of the prior security holder and may exercise the same rights under the security interest provisions of the rule as the prior security holder.

In other instances, where the Government entity involuntarily acquires assets to which the security interest provisions would not apply, the involuntary transfer or acquisition provisions of EPA's rule would apply to protect against liability.

The rule also recognizes that governmental entities may acquire property through other mechanisms, such as through civil and criminal seizures and asset forfeitures.

Accordingly, EPA is seeking comment on regulatory language that would specify that such acquisitions be deemed involuntary within the meaning of superfund.

EPA understands this committee's concern that the proposed rule does not address liability of lenders under other Federal environmental statutes. However, we do not have evidence upon which we can reasonably rely to demonstrate that risks of potential liability under other statutes has significantly affected credit actions of lending institutions.

If the public comments to EPA's proposed rule provide us with this information, we will have a basis upon which to address that situation.

That concludes my prepared testimony, Mr. Chairman, and I am happy to answer any questions you may have.

Thank you.

[The complete statement of Raymond B. Ludwiszewski follows:]

STATEMENT OF
RAYMOND B. LUDWISZEWSKI
ACTING ASSISTANT ADMINISTRATOR FOR ENFORCEMENT
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
JUNE 12, 1991

Good morning, Mr. Chairman and members of the Committee. I am Raymond B. Ludwiszewski, Acting Assistant Administrator for Enforcement at the U.S. Environmental Protection Agency. Thank you for the opportunity to be here today to discuss the liability of lending institutions and various federal financial institutions under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA or "Superfund").

In general, CERCLA imposes strict liability on owners and operators of property for the release or threatened release of hazardous substances. Section 101(20)(A) of CERCLA excludes from the definition of "owner or operator" those persons who hold indicia of ownership primarily to protect a security interest, provided that those persons do not "participate in the management" of the facility securing the loan.

Recent judicial decisions have created uncertainty concerning the scope of the CERCLA security interest exemption. Banks and other lenders are not certain when, in the course of ordinary dealings with a borrower, they may be deemed to have participated in the management of a borrower's business and thereby voided the exemption. This uncertainty over potential CERCLA liability affects the availability of credit and interferes with normal business relationships between lenders and borrowers.

Last year, my predecessor, James Strock, on behalf of the Administration, committed to propose a rule that would provide private and governmental lenders and other holders of security interests with clear and unambiguous guidance concerning their potential liability under CERCLA. I am pleased to report to you that EPA has completed this effort. A proposed rule is now publicly available that defines when holders of security interests are protected from liability. In particular, EPA's proposed rule specifies when lenders cross the line from their typical "creditor" status and become liable because they have participated in the management of the facility. The proposed rule is currently being readied for publication in the Federal Register. A copy of the proposed rule is attached to this testimony.

The Administration is confident that the proposed rule, which is the result of a unique cooperative effort among EPA, the Department of the Treasury, DOJ, and the White House's Council on Competitiveness, provides the needed measure of certainty where court decisions may have engendered confusion. We are also confident that the proposed rule will provide clear guidance for the lending community so that they may responsibly manage their loan portfolios without undue fear of environmental liability.

The Administration believes that this cooperative effort has resulted in a proposed rule that successfully implements each of the goals enumerated in EPA's testimony of last year:

- that the Superfund "security interest exemption" should be interpreted to allow lenders to undertake a variety of actions during the life of the loan, including so-called "loan workouts" with financially distressed borrowers, and to foreclose on property;
- that lenders should be permitted, without fear of incurring strict liability under CERCLA, to require borrowers to perform environmental inspections prior to or during the life of a loan, take preventative and mitigative actions to respond to potential releases, and engage in other prudent actions to minimize the risk of contamination and threats to public health and safety; and,
- that the benefits of a publicly-financed cleanup should inure to benefit of the public and not to the security holder.

In addition to clarifying the rules of liability for the private lending community, the proposed rule addresses the concerns faced by governmental lending and financial regulatory entities, as well as the FDIC and RTC. Governmental entities that acquire assets involuntarily, for example, in their capacity as a conservator or receiver, may acquire some assets to which the security interest provisions of EPA's rule will apply. In such cases, the governmental entity stands in the shoes of the prior security holder and may exercise the same rights under the security interest provisions of the rule as the prior security holder.

A governmental entity such as the RTC may also involuntarily acquire assets to which the security interest provisions of the rule would not apply. For example, assets which the predecessor did not hold as protection for a security interest or assets of a lender that impermissibly participated in the management of the borrower's enterprise would not qualify for the security interest provisions of the rule. However, such assets would be deemed to have been involuntarily acquired and the "involuntary transfer or acquisition" provisions of EPA's rule generally would apply to protect the governmental entity against liability.

The rule also recognizes that governmental entities may acquire property through other mechanisms, such as through civil and criminal seizures and asset forfeitures. Accordingly, EPA is seeking comment on regulatory language which would specify that such acquisitions shall be deemed "involuntary" within the meaning of CERCLA.

EPA understands this Committee's concern that the proposed rule does not address liability of lenders under other Federal environmental statutes. We do not have any evidence upon which we can reasonably rely that demonstrates that the risk of potential liability under statutes other than CERCLA has significantly affected the credit actions of lending institutions. However, we are aware that there may be an issue with respect to liability of lenders under the underground storage tank provisions of the Resource Conservation and Recovery Act (RCRA). In this context, the Administration believes that the secured creditor provisions of RCRA should be interpreted and applied in a manner consistent with EPA's proposed rule under CERCLA.

That concludes my prepared testimony, Mr. Chairman. I am prepared to answer any questions which you may have. Thank you.

The CHAIRMAN. Mr. Hill, let me ask you, I listened to your statement carefully. Why is the administration so reserved in its endorsement of legislation when you clearly believe that the lenders uncertainty with respect to the risk of environmental liability is worsening the credit crunch and is likely to damage the prospects for economic recovery?

Mr. HILL. Mr. Chairman, I think our support for the legislation has been made clear in the testimony on a point-by-point basis. When we prepared the testimony and began work, it was focused primarily on the security interest exemption that was dealt with in the EPA rule.

The administration would support the codification of that rule as it relates to the security interest exemption and would support Senator Garn's bill with respect to the points that I laid out in our testimony.

The CHAIRMAN. Let me ask all of you, what is your view of legislation that would allow Federal financial regulatory agencies that liquidate private lenders to recover their losses first in the liquidation of the failed lender?

Mr. Kelley, what's your view on that?

Mr. KELLEY. Mr. Chairman, the Federal Reserve, only under unusual circumstances that have not yet ever occurred, would have faced this issue head on.

My thought would be that it would be appropriate to have this sort of a preference in terms of the public recovering its losses ahead of private lenders.

But I would not know what position the Board might take on this, in view of the fact that it's a condition that has never emerged as yet in the course of our responsibilities.

The CHAIRMAN. Mr. Hill?

Mr. HILL. Mr. Chairman, on the subject of depositor preference proposals, it's the Treasury's view that this issue was, as Chairman Seidman said, considered in 1986.

And while it might well be useful to examine in the context of CERCLA liability, I would, in order not to repeat anything that Chairman Seidman said, say that the Treasury would have some concerns about the broader impacts of a Federal deposit preference: We investigated this proposal when we prepared the financial services legislation that we submitted to the Congress this year, because of the impact of off-balance sheet items such as letters of credit or interest rate swap portfolios of commercial banks.

The CHAIRMAN. Ray?

Mr. LUDWISZEWSKI. Mr. Chairman, this issue was first raised with me by your staff just the day before yesterday. I can't say that the EPA has a specific position on it. We certainly would be happy to work with you on it, and I would have to say that in doing so, we would probably be deferring to Treasury, which has much greater expertise in this area.

The CHAIRMAN. Let me ask all of you again, should legislation, if we're going to have legislation here, should it focus only on the lenders whose credit underwriting activities may cause a loss to the Federal Government?

Mr. KELLEY. Mr. Chairman, if I understand your question correctly, I think it's very important that private lenders receive the same protection and that they receive it in a very clear and unequivocal manner.

As has been alluded to earlier in this hearing this morning, there is a certain seizing up of credit extensions that is going on in the private sector as a result of the newly emerging liability that has been coming up through the courts where the exemption is being held to be invalid.

I think it's very important, both in terms of the financial system and also in terms of getting on with environmental cleanup, that the private sector lenders receive this sort of protection as well, and that they receive it in an unequivocal manner.

Mr. HILL. I agree completely, Mr. Chairman. I think both private and public lenders need to be as fully protected as possible and that we reduce the uncertainty which clearly, from our view, has contributed to the credit crunch that we face in our country.

Mr. LUDWISZEWSKI. The EPA doesn't want to do anything that would unduly contribute to the credit crunch, and we understand that that impacts both private and public lenders, so we would expect that the protection should go to both in an appropriate manner.

The CHAIRMAN. Mr. Kelley, I want to just ask you one other thing, and then if Senator Garn has additional questions, he will want to pursue those with you, too. But I want to move to a different area for a minute.

You sit there on the Federal Reserve Board. We're about to have nearly 60,000 people in Michigan at the end of this week have their unemployment compensation benefits expire. They're not going back to work because the unemployment rate is up around 10 percent. We've got a real problem in my State. It's not unique to my State, but that's the dimension in at least that category that's very urgent and very real for people.

There's a lot of economic data out there. You're looking at all of it as we are.

The last time Chairman Greenspan was here, he said the economy was still headed down and he wasn't convinced that it had hit bottom.

Have we hit bottom? Are we started up? Are we still going down?

Where are we?

Mr. KELLEY. I don't think it's possible to give an unequivocal answer to that, Mr. Chairman. But all of the evidence that has been coming in recently, and I think virtually all of the evidence since Chairman Greenspan made those remarks to which you allude, has been on the positive side.

Things are looking better. As new data come forward, it looks more and more as if this recession is bottoming out. What that says about the ensuing rebound is another matter. What it says about whether we will stay at approximately the level of activity we are now for an extended period may be another matter. But it does appear from incoming evidence that there is a bottoming out that is occurring.

The CHAIRMAN. I take it from the comment that you make, though, that it's possible that we're bottoming out to a plateau that we then may stay on.

Mr. **Kelley**. I can't foreclose the possibility that that would occur. I think that the normal dynamics of the American economy would indicate that there will be a rebound that will follow in due course from this bottoming out. But exactly what that pattern might trace and if in fact it emerges over coming months is impossible for me to forecast.

The **Chairman**. Well, in due course could mean a lot of things. It could mean maybe a long time in the future.

I guess the concern I want to convey to you, coming from the part of the country where I come from, is we've got serious economic problems. There's not much sign of them getting better.

Car and truck sales remain very, very weak, as I'm sure you know, and the unemployment numbers continue at a very high level. And as I say, we're exhausting the extended unemployment benefits and the number of people that are left now without unemployment compensation to hold their lives together will number in the tens of thousands in my State.

Now, we're one of 50 States, but this is not a small problem. This is a big and serious problem. I would hope that the Fed, in its decisionmaking and actions, within the latitude that it has, will look very closely at how the economy is performing and assist in whatever ways you can in getting some lift into the economy.

I'm discerning very little lift in the economy, quite frankly. And if we are bottoming out, that may be cold comfort if we're bottoming out and are likely to then stay on a plateau of very subpar economic performance.

And so, I wanted to note that for you. We don't often get the other Fed members in here, but I'm pleased to have you today. It wouldn't be appropriate, in my view, to have you here and not at least make these comments to you.

Mr. **Kelley**. Thank you, Mr. Chairman. I understand and share your very valid concerns and we are of course giving it our very closest attention and most careful consideration every day and we'll continue to do that.

The **Chairman**. Senator Garn?

Senator **Garn**. Thank you, Mr. Chairman. Mr. Hill, welcome back to the committee. In your prepared statement, you note that, and I quote, "The EPA rule has the force and effect of law and will bind third-party actions."

Last fall, in October, October 25, 1990, as a matter of fact, the Treasury wrote a letter to OMB, and I quote:

Generally, we are not convinced that the issuance of the EPA regulation is the most appropriate action that should be taken by the Federal Government at the present time with respect to CERCLA. It is unclear what weight the courts will accord this rulemaking, in view of the fact that several courts have already construed some aspects of lender liability under CERCLA. We are concerned that issuance of the regulation may remove any incentive on the part of Congress to expeditiously address other important CERCLA liability issues. In this context, it may be more appropriate to pursue a legislative approach to CERCLA liability issues.

Have there been any court cases, any legal developments since October that have changed Treasury's position from October until now, just that this is absolutely guaranteed, no problem, takes care of everything?

What's happened since October?

Mr. HILL. No, Senator.

Senator GARN. I like the October letter.

Mr. HILL. Thank you. [Laughter.]

I would say the following. You asked for our view and it came up also in the House hearing last week, concerning Treasury's view of the legislative rule. Our view is that a legislative rule, once made final, is binding on both public and third parties and has the force of law.

I might add, however, that clearly, codification of these provisions is a firmer and more permanent change that creates even less uncertainty.

But we did want to express our opinion on a legislative rule, and that is why we have put what we have in testimony.

Senator GARN. Mr. Kelley?

Mr. KELLEY. Senator, if I may add a comment there. I think that we feel that legislation is very important. I think that what we must have to solve the problem here is a very strong level of certainty and clarity as to exactly what the prevailing conditions and standards are.

It needs to be a settled situation once and for all as to exactly what standards need to be met.

We have a concern—I'm not a lawyer. I can get into technical trouble.

Senator GARN. Congratulations.

Mr. KELLEY. I can get into technical trouble quickly here. But we have a concern that if there is not legislation that provides certainty and clarity and a settled situation, that it will very possibly remain unsettled for a substantial period of time, and that indeed, there could ultimately be a perverse result that would frustrate the intentions of these regulations.

I think that the reason we're here today is because of a perverse result that occurred some years after litigation that some members have indicated is contrary to the intention of Congress' original intent.

We would hate to see that happen again and we would hate to see the threat of that hanging over this area for an extended period of time.

Senator GARN. Well, I understand Treasury's position and I too am not an attorney. But I don't have to be one to figure out that it's very easy, no matter what the legal interpretation is, that that rule, even if it's a legislative rule, is going to be a lot more subject to interpretation and challenge than a statute.

Mr. KELLEY. Right.

Senator GARN. When you consider that we should not even be here today, except for some damn fool courts that can't read plain English.

It's very clear on two occasions in the original law in the 1986 amendment—this Congress fully intended to do exactly what I'm trying to do now. And where these judges with their God complex come from, that they can read this language that isn't fuzzy, isn't really subject to interpretation, and come up with putting us in this position—probably what I ought to be doing is figuring out some way to pass an amendment that would make judges nonattorneys, that you're forbidden from going to law school. [Laughter.]

Or that they put commonsense classes into law schools of this country.

I don't know whether you're aware of this or not, and I've got to get off this subject because I can go on at great length. Do you know that 80 percent of all the attorneys on Earth are in the United States of America? And do you know there are more attorneys in the Washington, DC, area than in all of Japan?

That would solve the chairman's problem in Detroit. We don't have a problem with automobiles. It's a problem of the attorneys gumming up the whole works. In fact, a Japanese delegation said, in our country, Senator, we train engineers and scientists. You train attorneys.

That sums it up.

Well, now, I've made all my attorney friends happy once again, but they've heard this before.

So I think it is very clear in light of what happened to the original superfund law, and to the 1980 act, we need to codify this and put it into law.

Mr. Kelley, you noted that there is a widespread problem of banks walking away from property that might be contaminated instead of foreclosing and risking liability for cleanup. They just walk away from it.

I'd like to ask not only you, but the rest of the panel, what happens to such property? The bank sits there and they say, hey, we're not going to do that. We're just going to walk away from the loan. It's cheaper.

What happens to the property then?

Mr. Kelley. I need to pass that question to my colleagues here at the panel. I really do not know what the answer to that question is.

Mr. Hill. In a scenario like that, Senator, in my view, not only do you create disincentive—resulting from uncertainty for bankers not to provide credit to businesses to deal with a potential hazardous situation, but because there's no credit, you create a scenario where business people simply file chapter 11.

So in my view you have, without certainty and without the protections incorporated, in the EPA rule and in your bill, you create a situation where banks walk away from collateral, walk away from loans, and borrowers file chapter 11.

Then what you're left with, then, is a property that's in possession of a bankruptcy trustee situation. You have a terrible situation that underscores the whole credit crunch problem we're talking about, access to new capital, to employ people and make products, and working with borrowers in a known troubled situation, either because of the financial condition of the company or because of a hazardous substance problem.

Senator Garn. Let me carry this one step further. Doesn't it make sense to limit the liability of the lender so that they take over and start limiting the contamination, because my bill doesn't give them a blanket exemption once they take over.

So from an environmental standpoint, it makes sense to have somebody come in and put up the fence and start doing something about it, containing it.

I would suggest that limitations on liability obviously are an environmental improvement as well, rather than just letting it sit there in limbo. Nobody's responsible for it.

Would you agree with that?

Mr. **Ludwiszewski**. Unquestionably, foreclosure and then environmentally responsible activity by the bank can be superior in those circumstances, which is in part why the EPA-proposed rule permits a bank to foreclose without triggering unlimited joint and several superfund liability.

Mr. **Kelley**. Senator, if I may, I understood your question to be what happens to a property after a bank walks away from it?

It's very clear to me that it would further environmental interest if the lender liability exemption were there so that that would not have to occur and so that credit could be more comfortably and reasonably extended.

A business that goes under, ceases to exist, is not going to be able to deal with its existing environmental problems. It will leave them behind. It will leave it in the public domain to be settled on some basis.

If that business can obtain reasonable credit, then you have the prospect that it will, in its own enlightened self-interest from a number of different standpoints, it will deal with its pollution problems once it becomes clear what they are.

But if it is forced by its lender to go out of business through inability to obtain credit because the lender is fearful of extending that credit, then that is not going to help the borrower, the financial institution, or the Government or the environmental interest that we all share.

Senator **Garn**. Thank you. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn.

Gentlemen, thank you for your testimony. We're going to excuse you now and call our next panel.

Before we do, Mr. Kelley, let me just say, I mentioned earlier the number of workers in Michigan that are about to be pushed off, have their unemployment compensation benefits expire, although they're still unemployed and out of work.

The figure is 48,000. That is the number that are about to have their benefits discontinued.

So that's one State. But believe me, this is a big human problem out there. We're going to find some answers to it.

Thank you all and let me excuse you now and call our next witnesses to the table.

Let me invite our witnesses to be seated and others that are leaving, to do so as quietly as they can, and others that are remaining, to find a seat.

Let me welcome you—Mr. Wolf—is it Mr. Fort or For-tay?

Mr. **Forte**. For-tay.

The **Chairman**. Mr. Forte. Mr. Simmons—former Chairman Garn wants to make a comment or two about Mr. Simmons.

Senator **Garn**. Thank you. Well, I welcome all of you witnesses, but I would particularly like to welcome Mr. Simmons. He is president and chief executive officer of Zions Bancorporation and Zions First National Bank in Salt Lake City.

He and his father are long-time friends of mine back in the days—well, Harris was too young, but when I was mayor, his father and I were good friends. I have been using his bank in my speeches on lender liability over and over again. This is the president of the bank that took over the failed Toyota dealership that I have used over and over again.

So I'm sure that he can expound on specific examples of the problem that this has created.

But I welcome all of you here, and particularly Mr. Simmons.

The **Chairman**. That's what you get for lending to a Toyota dealership. [Laughter.]

Senator **Garn**. I don't know how in the world a Toyota dealership can go bankrupt. [Laughter.]

The **Chairman**. Let me also indicate that David Adcox is a witness here as well. I had omitted his name earlier, for which I apologize. He's the president of Highland Corp. from Tennessee, who is here representing the Petroleum Marketers Association of America. So we welcome him as well.

We're going to make your full statements a part of the record. I'm going to ask each of you to try to summarize within the 5-minute time period so we have time for questions.

Mr. Wolf, we'd like to hear from you now. Pull the mike right up close, if you would.

STATEMENT OF DOUGLAS WOLF, NATURAL RESOURCES DEFENSE COUNCIL, WASHINGTON, DC

Mr. **Wolf**. Thank you, Mr. Chairman.

I'm going to focus on S. 651, but I'd like to call the Chair's attention to a study that's just been conducted, released by the Southern Finance Project. You may be familiar with their work. It gives some background on the evolution of EPA's lender liability rule and I think the letter to OMB from Treasury that Senator Garn, you referred to earlier, is something that is addressed in this matrix.

My name is Doug Wolf. I am an attorney—I admit that—with the Natural Resources Defense Council. I'm also testifying on behalf of——

Senator **Garn**. We appreciate your honesty. [Laughter.]

Mr. **Wolf**. Full disclosure, Senator. I'm testifying on behalf of the U.S. Public Interest Research Group as well.

In documents recently submitted to the Senate Superfund, Ocean and Water Protection Subcommittee, EPA makes the following findings.

One, of the 18,392 notice letters it has sent to potentially responsible parties at superfund sites, none have ever been sent to the FDIC or the RTC.

Two, EPA's search of its records reveals only six superfund sites where Federal entities have ever been involved.

And three, in the almost 12-year history of the superfund program, only eight lenders have ever been identified as responsible parties.

In other words, and math is not my strong point, according to EPA, only 0.04 percent of all the responsible parties ever identified have been lenders. And the FDIC and RTC have never been so identified.

Documents that the FDIC and RTC have submitted to the same subcommittee establish that the percentage of properties these Federal entities hold that have potential environmental problems, at least problems they've identified so far, are 1.65 percent for the FDIC and 0.66 percent for the RTC, hardly an overwhelming burden.

Let me turn to Senate bill 651.

If there is a lender liability crisis, and the numbers I've just read suggest that there is no such crisis, S. 651 is not going to solve this problem. Instead of amending the superfund statute, which has generated so much concern, S. 651 uses broad generalities to amend various banking statutes. If enacted, S. 651 would create a nightmare for the regulatory agencies, courts and businesses which would have to interpret it. Lawyers, again. Their task would be to take the largely undefined terms in the bill and compare them with the very terms in the superfund statute that the bankers have found ambiguous.

EPA would have to issue guidance documents. Courts would have to probe legislative histories and dictionaries. And bankers would be more confused than ever before.

Particularly absent from the bill's language is any clear statement or definition of just when a lender would cross the line from merely policing its security interest to risking superfund liability.

And note that this is the Fleet factors issue that began this crisis.

S. 651, if enacted, would add a new loophole to the hazardous waste laws. The first subsequent purchasers for all properties owned by Federal agencies, as well as the agencies themselves, would escape all liability for hazardous waste contamination, as long as they take reasonable steps to prevent the continued release of hazardous materials discovered prior to or after the purchase.

That's the language of the bill.

The implications of this loophole are serious. First, creative lawyers—again, lawyers, the problem—will be able to stretch this loophole beyond recognition by using the identity of the subsequent purchaser corporation to confer immunity on all subsequent operations at the site.

Second, the incentive for Federal banking and legislative agencies and their subsequent purchasers to carefully examine their hazardous waste contamination problems will disappear as S. 651 imposes no due diligence requirement and only requires cleanup action if the release of hazardous materials is actually discovered.

Third, this loophole preempts State, statutory and common law, a serious blow to many well-crafted and administered State liability programs.

Finally, fourth, lenders and first subsequent purchasers will have no incentive to clean up contaminated sites, so these sites will wait in toxic limbo until very serious problems emerge and the tax-supported superfund will have to step in and pay for the cleanup.

S. 651 allows lenders to limit their liability in another way. It allows them to limit their liability if they acquired the property by foreclosure.

The current system's liability incentives to conduct due diligence before a loan is made and to police loans during their lifetime are largely based on the threat of owner-operator liability if the lender has to foreclose. By eliminating this liability scheme and only requiring due diligence efforts before loans are made, S. 651, if enacted, would eliminate most current efforts to police loans and to conduct environmental assessments before foreclosure.

Such policing efforts and assessments have become a very positive force for the identification and remediation of hazardous waste problems.

Based on the EPA statistics I mentioned earlier, as well as the work of the Southern Finance Project, NRDC and USPIRG believe that our initial suspicions that lenders are not experiencing widespread environmental liability is correct.

Given this, we are unwilling to accept unnecessary and overbroad solutions such as S. 651. If there is a genuine need for reform, we are willing to work with this committee, EPA and other interested parties to clarify any uncertainties in the superfund statute or case law which are creating problems.

Above all, on behalf of the environmental community, let me stress that the superfund liability standard which is helping clean up America and reduce pollution must be preserved intact.

Thank you.

The CHAIRMAN. Thank you, Mr. Wolf.

Mr. Forte?

[The complete statement of Douglas Wolf follows:]

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Testimony of

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and
The U.S. Public Interest Research Group

on

Lender Liability and S. 651

Before the

Senate Committee on Banking, Housing and Urban Affairs

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Lender Liability/S. 651
6/12/91 Testimony

Introduction

Thank you, Mr. Chairman and members of the Committee, for this opportunity to speak with you about lender liability and S. 651. I am Doug Wolf, a senior attorney with the Natural Resources Defense Council (NRDC). NRDC is a non-profit environmental protection organization, founded in 1970 and supported by 170,000 members throughout the U.S. U.S. Public Interest Research Group (U.S. PIRG) is the national lobbying arm of the state PIRGs, which are consumer environmental advocacy organizations with over one million members across the country.

Summary

NRDC and U.S. PIRG (the "Environmental Groups") have long questioned the factual basis for the lender liability crisis described by the American banking industry. In fact, new EPA statistics confirm that no such factual basis exists. Despite the evidence that there is currently no liability problem warranting a legislative solution, Senator Garn has introduced S. 651 and EPA has proposed a rule interpreting the provisions of the Superfund statute which relate to lender liability.

S. 651 The Environmental Groups strongly oppose this proposed legislation. It will create more ambiguity than it will resolve and it creates significant new loopholes which will slow the pace of badly needed hazardous waste cleanups.

EPA Rule The Environmental Groups oppose the provisions of this proposed rule which give lenders who foreclose and then seek to sell properties a blank check to continue old or initiate new polluting practices. This new loophole makes the absence of any requirement in the rule that lenders undertake due diligence efforts particularly dangerous.

If there is a genuine need for reform, which the Environmental Groups doubt, the Groups are willing to work with this Committee, EPA, and other interested parties to clarify the uncertainties some claim were created by the Eleventh Circuit's opinion in United States v. Fleet Factors Corp. and to clarify the role of the FDIC and RTC in the Superfund liability scheme. However, S. 651 and EPA's proposed rule go way beyond fixing Fleet Factors and clarifying the meaning of "government entity" in CERCLA -- and pose grave risks to the liability scheme that is helping to clean up America and reduce pollution.

What Crisis?

The genesis of this crisis is supposedly the dictum in the Eleventh Circuit's opinion in United States v. Fleet Factors Corp. which suggests a lender's policing the quality of its collateral could create Superfund liability if the lender had an unexercised capacity to influence the borrower's environmental practices. This brief and non-binding discussion horrified the banking community and has led to a large-scale campaign, spearheaded in large part by federal bankers at the FDIC and the RTC, to "fix" this and many other aspects of the hazardous waste laws that these bankers find inconvenient.

This is much ado about nothing. In documents recently submitted to the Senate Superfund, Ocean, and Water Protection Subcommittee (Superfund Subcommittee), the Environmental Protection Agency (EPA) asserts:

-- of the 18,392 notice letters it has sent to potentially responsible parties (PRPs) at Superfund sites, none have ever been sent to the FDIC or the RTC;
-- EPA's search of its records reveals only six National Priorities List (NPL) Superfund sites where federal entities have been involved;
-- In the almost twelve year history of the Superfund program, only eight lenders have ever been identified as PRPs.

In other words, according to EPA, only .04% of all the PRPs ever identified have been lenders and the FDIC and RTC have never been so identified[1].

In April 11, 1991 testimony before the same Subcommittee, the FDIC asserted it controls 238 assets with potential environmental problems and has obtained clean-up estimates for 117 of these assets. The RTC asserted it has identified approximately 300 RTC properties that have potential environmental problems. In documents they submitted to the Superfund Subcommittee the FDIC notes that it owns or has interests in 14,409 properties and the RTC notes it owns 45,665 properties. Thus, the percentage of properties these federal entities hold that have potential environmental problems[2] are 1.65% (FDIC) and .66% (RTC). Hardly an overwhelming burden.

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[1] The FDIC provides slightly different numbers: the FDIC claims to have received one notice letter and the RTC claims to have received two. Using these numbers, the two federal entities would comprise .016% of all PRPs, a very small percentage.

The Banks Seek to Defy the Public

Despite the tiny number of actual problem sites, the FDIC, the RTC, and the U.S. banking industry are trying to convince us that a lender liability crisis exists. Faced with a lack of solid proof, representatives of these interests argue there is a perception that a crisis exists and that this perception is the real crisis. Despite the fact that the Superfund statute creates special protections for lenders -- particularly government entities (like the FDIC and the RTC), these representatives have developed complex, and unconvincing, "ambiguities" in the law to support their crisis.

Their motive? These government entities and America's bankers want a special deal. Since the Superfund program was established over a decade ago, one category after another has sought to justify its special need to escape Superfund liability. This list includes government facilities, municipal properties, insurance companies, and many, many others.

The problem with these attempts is that Americans believe in the Superfund liability scheme the bankers want to change. They believe in it because:

1) it requires polluters to pay for hazardous waste cleanups, something Americans emphatically don't want to do themselves, and
2) it forces American industry, including the banking industry, to police hazardous waste creation, handling, and disposal.

Accepting this political reality, in 1990, Congress reauthorized the Superfund program for an additional three years without making any changes.

The banks' request for special treatment is outrageous, given the recent performance of the banking industry. Because the nation's banks made so many bad business decisions during the 1980s there is now a banking crisis. At the heart of this banking crisis is the widespread collapse of the U.S. real estate market, which has, in turn, led to a widespread collapse or weakening of many types of American lending institutions. This collapse has helped create and continue a prolonged downturn in our economy. Yet instead of changing the short-sighted approach to business that created this economic disaster, these same bankers now ask us to let them forget about the potential environmental problems they have helped bankroll, at least until they can pass them off to another owner or until the tax-funded Superfund picks up the tab. Despite all the other causes of our economic troubles -- our addiction to debt, the lack of competitiveness of our industries, the increasing problems of our major urban areas, and the list goes on and on -- these bankers intimate that eliminating their Superfund liability will somehow make the difference and put the economy on the road to recovery[3].

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[2] The FDIC/RTC submissions explain that a very broad definition of potential environmental problems was used and that these data are very preliminary.

The American public just won't stand for this. This summer environmental activists will be canvassing door-to-door to focus general public support for environmental issues into specific support for sweeping revisions to the Resource Conservation and Recovery Act (RCRA) and to the Clean Water Act. A critical element of this agenda of change is a strategy to implement new provisions in these statutes to promote pollution prevention. "Pollution prevention" is shorthand for the sensible desire to create incentives to reduce the use of toxic chemicals in all aspects of industrial production.

The most important force for pollution prevention today is the Superfund liability standard. The fear of cleanup liability leads companies to reduce their use of polluting chemicals and leads companies and banks to carefully scrutinize all transactions for environmental risk. If the American public learns that Congress is seriously contemplating changing this liability standard so that our banks have much less incentive to avoid financing pollution, The Environmental Groups are convinced the public's reaction will be strong and negative.

Further, the GAO report released yesterday, which details the RTC's sloppy administration of its duties, does not inspire confidence that now is the time to reduce the FDIC's and RTC's incentives to carefully examine their holdings for hazardous waste problems.

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[3] It is interesting to note that the economic crisis was already well underway before the Eleventh Circuit released it opinion in United States v. Fleet Factors Corp., the event that supposedly triggered the lender liability crisis.

S. 651

1. More Ambiguity, Not Less

S. 651 won't improve this situation. Instead of amending the Superfund statute, which has generated so much concern, S. 651 uses broad generalities to amend various banking statutes. If enacted, S. 651 would create a nightmare for the regulatory agencies, courts, and businesses which would have to interpret it. Their task would be to take the largely undefined or circularly defined terms in the bill and compare and contrast them with the very terms in the Superfund statute[4] the bankers have found so ambiguous. EPA would have to issue guidance documents, courts would have to probe legislative histories and dictionaries, and bankers would be more confused than ever before.

Particularly absent from the bill's language is any clear statement of just when a lender would cross the line from policing its security interest to "actively direct[ing] or conduct[ing] operations that result in the release of a hazardous substance."

In this respect, the approach taken by EPA's proposed rule is vastly superior: the preamble explains in theory and by example how one can make the above distinction between policing a loan and displacing the borrower's control of the collateral[5], and, by interpreting the language of Superfund, the rule prevents the confusion caused by adding undefined words from one statute to undefined words in another statute.

2. Big, New First Subsequent Purchaser Loophole

S. 651, if enacted, would add a big new loophole to the hazardous waste laws: the first subsequent purchasers for all properties owned by Federal agencies[6], as well as the Agencies themselves, would escape all liability for hazardous waste contamination as long as they "take reasonable steps to prevent the continued release of hazardous materials discovered prior to or after the purchase."

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[4] Although S. 651 would theoretically amend RCRA and the Clean Water Act as well as the Superfund statute, EPA's submission to the Senate Superfund, Ocean, and Water Protection Subcommittee establishes that lenders have experienced essentially no problems under these statutes, which have been in existence even longer than the Superfund program. Discussing potential problems caused by these statutes would appear to be little more than an academic exercise.

[5] The Environmental Groups are concerned that this definition is overly broad and expects to participate in the opportunity for comment offered by EPA.

The implications of this loophole are serious:

-- creative lawyers will be able to stretch this loophole beyond recognition by using the identity of the subsequent purchaser corporation to confer immunity on all subsequent operations at the site;

-- the incentive for Federal banking and lending agencies and their subsequent purchasers to carefully examine their hazardous waste contamination problems will disappear as S. 651 imposes no due diligence requirement and only requires cleanup action if the release of hazardous materials is actually discovered;

-- this loophole preempts both Federal statutory law and state statutory and common law, a serious blow to states' rights and an insult to the many well-crafted and administered state liability programs[7];

-- lenders and first subsequent purchasers will have no incentive to clean up contaminated sites so these sites will wait in toxic limbo until very serious problems emerge and the tax-supported Superfund will have to step in and pay for the cleanup.

3. Due Diligence Regulations Offer Little Comfort

S. 651 allows lenders to limit their liability if they acquired the property via foreclosure. This creates a tremendous loophole because the current system's liability incentives to conduct due diligence before a loan is made and to police loans during their lifetime are largely based on the threat of owner/operator liability if the lender has to foreclose. S. 651

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[6] This term is so broad it would include agencies such as the Small Business Administration, Farmers Home Administration, and HUD. There is absolutely no empirical support for granting so many federal entities this broad loophole.

[7] The Environmental Groups are aware that S. 2827, the 1990 version of this bill, preempted state law liability in regards to all lenders, not just for Federal lenders and their first subsequent purchasers. The Environmental Groups appreciate this and other improvements Senator Garn has made in his proposed legislation. Still, the Groups are concerned that the loophole the first subsequent purchaser exemption will create may produce a similar result.

lamely attempts to fill this hole by requiring Federal banking agencies and HUD to promulgate regulations requiring due diligence efforts prior to making loans.

Not only does this language give no assurance as to the scope of these regulations, but S. 651 requires no enforcement system to ensure that banks fulfill these obligations. Further, by eliminating the current liability scheme and only requiring due diligence efforts before loans are made, S. 651, if enacted, would eliminate most current efforts to police loans and to conduct environmental assessments before foreclosure. Such policing efforts and assessments have been a very positive force for the identification and remediation of hazardous waste problems. S. 651 would leave many of these problems undiscovered until such time as their contamination was truly widespread and dangerous.

EPA's Proposed Rule

Many had hoped that EPA's long-awaited lender liability regulations would end the perceived crisis. Promulgating Superfund regulations on this subject offered the potential for removing the uncertainty that the banking community has managed to generate on this topic without creating vague new legislation with uncertain effects on the Superfund and other statutes. In some important ways, the lender liability rule EPA proposed last week fulfills this potential. Unfortunately, once the draft left EPA's hands, months ago, OMB, the Treasury Department, and the Office of the Vice President have managed to add many troublesome provisions which are irrational and inconsistent with the law.

1. The Foreclosure Loophole

The biggest hole in the proposed regulations is the near absolute immunity they grant to lenders' activities after foreclosure. The regulations set up a two-part test to establish what constitutes liability during the life of the loan and encourage, though they do not require, due diligence efforts before a loan is made. Unfortunately, once the property is foreclosed upon, all the lender's environmental responsibilities vanish. All the lender has to do to stave off potential post-foreclosure liability is to make efforts to sell the property and to not reject bona fide purchase offers.

In fact, this loophole is broader that the liability limitation contained in S. 651. Under S. 651 foreclosure does not cut off potential lender liability caused by acting as operator of the facility; instead, such liability is limited to when the lender actively directs or conducts operations that cause a release of hazardous substances. Under the proposed rule, this type of liability is completely eliminated. It is still possible to be liable for cleanup costs under the rule during the foreclosure period if the lender directly causes a release -- a circumstance canny lenders might seek to prevent by working through consultants or agents.

2. Due Diligence Requirement Eliminated

When EPA sent its version of the proposed rule to OMB it did not contain the foreclosure loophole described above. It also contained a requirement that, to qualify for the liability limitation described in the rule, lenders conduct environmental audits before making loans and a requirement that lenders insist that borrowers conduct any necessary audits and/or remediation needed to protect the quality of the loan collateral during the life of the loan.

If OMB, Treasury, and the Office of the Vice President hadn't gutted the liability provisions that apply during the foreclosure period it would not be so important to require due diligence efforts. This is the case because the lax liability requirements for the foreclosure period greatly reduce lenders' incentives to conduct such efforts.

Conclusion

The Environmental Groups believe their initial suspicion that lenders are not experiencing widespread environmental liability is correct. Given this they are unwilling to accept unnecessary and over broad "solutions" such as S. 651 or EPA's proposed rule. If there is a genuine need for reform, the Environmental Groups are willing to work with this Committee, EPA, and other interested parties to clarify any uncertainties in the Superfund statute or case law which are creating problems. For example, it is possible that some steps could be taken to clarify any uncertainties some claim were created by the Eleventh Circuit's opinion in United States v. Fleet Factors Corp. and to clarify the role of the FDIC and RTC in the Superfund liability scheme.

Above all, the Groups stress that the Superfund liability standard, which is helping to clean up America and to reduce pollution, must be preserved intact.

STATEMENT OF JOSEPH PHILIP FORTE, ATTORNEY, THATCHER, PROFFITT & WOOD, NEW YORK, NY, REPRESENTING THE AMERICAN BAR ASSOCIATION

Mr. **Forte**. Mr. Chairman, I am Joseph Philip Forte, with the real property, probate and trust section of the ABA, and I'm speaking on behalf of the American Bar Association.

I am a partner in the real estate practice group of Thatcher, Proffitt & Wood in New York City.

The bad news is I'm a lawyer. The good news is I'm in a non-growth industry for lawyers called real estate finance, and I'm not an environmental lawyer. I advise, however, banks and insurance companies and other lenders on environmental issues.

The American Bar Association has recently adopted two resolutions with respect to CERCLA liability. The first one is a recommendation to support legislation for exemptions for all corporate and individual fiduciaries from liability and to clarify the basis of any liability imposition on parties to a fiduciary relationship.

The second resolution deals with recognition of the necessity for clarification of the secured lender exemption under CERCLA.

These constitute the official policy of the American Bar Association.

The ABA appreciates the opportunity to present testimony to this committee stating the views of its 300,000 members. We do also welcome the opportunity to work with you and your staff to improve the statute for the benefit of the public.

In the lender and fiduciary context, we are not seeking to protect parties who cause or contribute to contamination. A financing community which was stunned by the Fleet Factors decision is merely seeking to restore original intent of Congress in enacting the secured creditor exemption which has been steadily and continually eroded by the courts.

To confirm Senator Domenici's comments, we have an example of a misapplication of the statute. In 1980, a small community bank in Montana, in a community with three banks, made a pre-CERCLA $275,000 loan with a 90-percent SBA guarantee. Its risk at that time was $27,500.

In 1984, the bank took part of the property by deed in lieu of foreclosure, but never recorded it and eventually returned the deed to the borrower. The SBA refused to accept the property.

In 1990, the bank received a special notice of designation as a PRP from the State of Montana. No allegation of cause or contribution was ever made. A Fortune 500 company was also liable, but the EPA is seeking one-half of the $10 million cost from the bank.

The bank has assets of $32 million and has unrestricted capital of $425,000. Now it has 40 times its original risk at stake and 10 times its capital. This could eliminate a community bank in an area where it's able to serve a community and the small businesses in that community.

The public policy and spirit of CERCLA is to encourage private cleanup, not to discourage financing. People who own property are not going to clean up contamination without the ability to get the financing to clean it up.

The only way to encourage cleanup is to allow lenders who lend funds not to be deemed liable simply because they put forth those funds.

After the Maryland Bank case, lenders had two choices—between foreclosure or establishing their outside limit of liability. After Fleet, the best position for lenders is to do nothing. To avoid foreclosure, they avoid ownership liability. To avoid a workout which may have created a better situation for the borrower and for the community, they have to avoid participation and management. By not requiring the borrower to do the things that a lender would ordinarily require to be done in the loan documents, they eliminate the capacity of control that Fleet spoke about.

By not requiring borrower action, lenders protect themselves from being adjudged to be in control.

Refraining from any action whatsoever allows them to merely forfeit principal and interest and avoid potential catastrophic liability.

The CHAIRMAN. Let me just stop you at that point.

We're in the midst of a rollcall vote and in order to keep going, I asked Senator Garn if he would go and vote early in the rollcall. He should be back momentarily.

I must go now or I will not get there before the vote ends. So when he comes back, I've said to him and I want to repeat now, I want him to continue the hearing in my absence. I'm going to try to get back here before we finish. If I don't, then I'm going to have Senator Garn finish the hearing.

But if I may ask you just to remain here, I think he'll be in within a minute or two and we'll continue. But I'm going to ask you to suspend for the moment for that purpose.

So the committee will be in recess until Senator Garn returns. Thank you. [Recess.]

Senator GARN [presiding]. The hearing will come to order.

Mr. Forte, if you'd please continue.

Mr. FORTE. Having addressed the first part of the ABA resolutions with respect to secured lenders, I'd like to turn to the fiduciary issue.

There is uncertainty under CERCLA whether fiduciaries incur corporate liability for properties held in trust, to which they neither caused nor contribute to contamination.

Without being overly technical or lawyerly, I'd like to just say that an owner concept is very difficult to apply to the fiduciary situation.

Who is liable? Is it the bank as trustee because they have legal title? Is it the beneficiary who has beneficial title, the equitable title to the property? Or is it the trust, the asset itself?

Now the problem with the trust asset is, unlike a corporation, the trust is not an entity and can't own property and can't be liable.

With operator liability, the problem is even greater. There is a need for legislation and obviously, the EPA has not addressed this at all.

There are two consequences of the uncertainty for fiduciaries. The first one is that lawyers give advice to avoid situations where there is any potential CERCLA liability. And you suffer needlessly great losses by fiduciary institutions which will either cause failures—a loss to the public of the service to the community banks.

As attorneys widely advise to avoid CERCLA situations, the fiduciaries are listening. Only less sophisticated, less qualified and less likely, whether intentionally or unintentionally, fiduciaries are not going to comply with the environmental laws.

Another consequence is that there is going to be avoidance of closely held corporations by fiduciaries. The reason is the nature of the control of the closely held corporation and there is a concern that if they are too close to control, their liability will be greater.

Greater financial failures will result among the close corporations as fiduciaries avoid—any sophisticated fiduciary would avoid the situation.

Unlike secured lenders, fiduciaries find themselves in a situation where it's very hard to avoid the liability at the outset. They may just find out they've been appointed by the court, et cetera.

There is a tension between being a fiduciary—being a fiduciary in relation to your beneficiaries and a fiduciary in relation to CERCLA.

There is an example that was given to us yesterday, to Mike Graham from Baker & Botts who wrote the fiduciary portion of this testimony, where a bank director passed away and his family attempted to have the bank act as a fiduciary on a small family farm. The bank went out to the property and saw some rusting drums, came back and said, after you sell the farm, we will be very happy—to a bank director's family—will be very happy to represent the estate.

Now, this tension between the fiduciary relationship is that the fiduciary, if he spends money, or does the assessment, or goes out and looks at the property, may be criticized for having spent too much money to protect himself in being overzealous in compliance with the law and wasting the asset when it's only his personal liability he was worried about.

But the problem with the statute also is that it deals only with the corporate fiduciary if there is one problem and it does not deal by necessity with individual trustees and fiduciaries, which should probably be covered.

The ABA urges Congress to enact the legislation in spite of the EPA's new and significant contribution to this area. Obviously, the courts have ignored the original congressional intent, as you pointed out.

Why would the EPA regulation fare any better, especially in the 11th Circuit? I think not. I think that the EPA has also not, unfortunately, protected fiduciaries. And the question of third-party liability—the liability under CERCLA to third parties by banks and fiduciaries and others—is clearly there. While it's a valiant attempt with the tie to the national contingency plan, I don't think—it may not be sustained in the courts. And that is a concern.

This is not a lender issue. This is a consumer issue, a public issue, an economic problem. Consumers, small businesses, cannot get credit. They cannot get a fiduciary for their estate if they own property, or a small business, or if they own a farm.

This has a chilling effect on lending and fiduciary relations between parties who want to have people take care of their estates. But it's not truly a lender and fiduciary problem.

The problem is that the spirit and intent of the statute was to pass the obligations for cleanups to the private sector. The way that it's being interpreted by the courts has placed a chilling effect on the only people that are ever going to finance that cleanup.

That is, the bank will never at a first instance finance a cleanup when by financing it, it may be deemed by some later regulator, to have been imprudent in financing the cleanup.

So it doesn't serve the purposes of the statute to have it enacted this way.

Thank you.

Senator GARN. Mr. Simmons?

[The complete statement of Joseph Philip Forte follows:]

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Statement of

JOSEPH PHILIP FORTE

of the

SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW

on behalf of the

AMERICAN BAR ASSOCIATION

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

of the

UNITED STATES SENATE

regarding

RISKS OF ENVIRONMENTAL LIABILITY OF LENDERS AND FIDUCIARIES

and

S. 651 TO CLARIFY OR LIMIT THOSE RISKS

June 12, 1991

SUMMARY

Upon the recommendation of the American Bar Association's Section on Real Property, Probate and Trust Law, the House of Delegates of the ABA adopted two resolutions regarding liability under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA, as amended by the Superfund Amendments and Reauthorization Act). One resolution recommends support of legislation providing for exemptions for corporate and individual fiduciaries from liability under CERCLA and clarification of the bases, if any, for imposition of liability under CERCLA on parties to a fiduciary relationship. The other resolution calls for the Congress and Environmental Protection Agency (EPA) to recognize the necessity for clarification of the "security interest" exemption under CERCLA. These resolutions now constitute the official policy of the ABA.

It should be clarified that we are not seeking protection for parties who actually cause a release or threatened release sufficient to require response action under CERCLA. With regard to lenders, we are seeking to restore the original intent of Congress in enacting the Secured Creditor Exemption. With regard to fiduciaries, we are seeking to clarify disturbing uncertainties in the law.

Lender Issues: Judicial misinterpretation of the Secured Creditor Exemption to CERCLA has nearly nullified the original intent of Congress in enacting the exemption. It has done so at the cost defeating CERCLA's central purpose of shifting the costs of cleaning up contaminated properties to the private sector by cutting off the financing is essential to paying those costs. The result for lenders may be to force them to choose between protecting their investments by means of normal prudent lending practices and avoiding the risk of CERCLA liability. The result for borrowers and the country at large is that lender liability under CERCLA is exacerbating the credit crunch that is contributing to our current economic recession.

Fiduciary Issues: The nature and extent to which CERCLA applies to parties to a fiduciary relationship is disturbingly unclear. These uncertainties need to be resolved by statute or regulation; otherwise, they will result in years of expensive and protracted litigation. Uncertainties as to the correct application of CERCLA will also force fiduciaries to settle cases where the fiduciary should have prevailed, shifting costs from polluters to insured institutions, charitable and individual beneficiaries, and other innocent parties. The normal response to uncertainty under a strict liability system is to do everything feasible to comply with the strictest conceivable interpretation. This response is likely to cause insured institutions to incur fiduciary liability for breaching the duty of loyalty owed to beneficiaries, including liability for punitive damages. Fiduciaries will inevitably make errors of judgment in attempting to reconcile the conflicting and uncertain mandates of their duties under CERCLA and their fiduciary duties, particularly when such judgments are reviewed with the benefit of hindsight. Furthermore, over-zealousness is often forgiven when the fiduciary is a family member, but history has shown that insured institutions are held to a higher standard and are not typically sympathetic defendants.

At the present time, and in view of the critical uncertainties, the only way for a fiduciary to clearly avoid CERCLA related liability is to exercise its right to refuse to serve as a fiduciary where CERCLA could be applicable. It would be better to keep qualified and knowledgeable professional fiduciaries as a part of those helping to carry out the objectives of CERCLA, which can be done through clarifying the bases of liability and affirming that an innocent fiduciary will not be liable.

Need for Legislation: Legislation is needed even if EPA promulgates a final rule substantially similar to the draft it released on June 5, 1991 regarding the "National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA" (the "Proposed Rule"). While the Proposed Rule is a significant step forward, legislation is needed to address problems of fiduciaries and problems of lessors as secured lenders. Legislation is also necessary to add clarity to EPA's attempt to make third parties subject to the rule. Moreover, legislation is needed to insure that the intent of Congress is carried out, rather than being nullified by misdirected judicial decisions.

Mr. Chairman and Members of the Committee:

I am Joseph Philip Forte, representing the Section of Real Property, Probate and Trust Law of the American Bar Association (the "ABA"), and I have been designated by John J. Curtin, President of the American Bar Association, to submit this testimony on behalf of the ABA.

Upon the recommendation of ABA's Section on Real Property, Probate and Trust Law, the House of Delegates of the ABA adopted two resolutions regarding liability under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA, as amended by the Superfund Amendments and Reauthorization Act). One resolution recommends support of legislation providing for exemptions for corporate and individual fiduciaries from liability under CERCLA and clarification of the bases, if any, for imposition of liability under CERCLA on parties to a fiduciary relationship. The other resolution calls for the Congress and Environmental Protection Agency (EPA) to recognize the necessity for clarification of the "security interest" exemption under CERCLA. These resolutions now constitute the official policy of the ABA. These resolutions, and my testimony here today, are limited to Section 152 of S. 651 addressing strict liability for lenders, fiduciaries and lessors for the release or threatened release of hazardous substances. Copies of the full resolutions and their accompanying reports are attached as Exhibits A and B, respectively, to this statement.

The ABA appreciates the opportunity to present testimony to this distinguished Committee stating the views of our membership (which is composed of more than 300,000 lawyers). We welcome the opportunity to work with you and your staff to improve the law and serve the interests of the public.

COMMENTS ON

RISKS OF ENVIRONMENTAL LIABILITY OF LENDERS AND FIDUCIARIES AND S.651 AND OTHER LEGISLATION TO ADDRESS THOSE RISKS

I will first address the risks of liability of lenders under CERCLA, followed by the risks of liability of fiduciaries under CERCLA, and the need for legislation to address both sets of problems.

At the outset it should be clarified that we are not seeking protection for parties who actually cause a release or threatened release sufficient to require response action under CERCLA. With regard to lenders, we are seeking to restore the original intent of Congress in enacting the Secured Creditor Exemption. With regard to fiduciaries, we are seeking to clarify disturbing uncertainties in the law.

I. LENDER ISSUES UNDER CERCLA

SUMMARY

Judicial misinterpretations of the Secured Creditor Exemption to CERCLA have nearly nullified the original intent of Congress in enacting the exemption. They have done so at the cost of defeating CERCLA's central purpose of shifting the costs of cleaning up contaminated properties to the private sector by cutting off the financing which is essential to paying those costs. The result for lenders may be to force them to choose between protecting their investments by means of normal, prudent lending practices and avoiding the risk of CERCLA liability. The result for borrowers and the country at large is that lender liability under CERCLA is exacerbating the credit crunch that is contributing to our current economic recession.

INTRODUCTION

The original CERCLA legislation, when enacted in 1980, provided an exemption for "a person who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."[1] By virtue of this provision, known as the Secured Creditor Exemption, Congress intended that security holders who do not cause or contribute to contamination and who do not participate in the management of a contaminated site would be exempt from the harsh scheme of strict, joint and several, retroactive, perpetual and, for practical purposes, unlimited liability imposed by CERCLA. Nevertheless, the courts have so eroded this provision that, in practice, the Secured Creditor Exemption currently offers little or no protection to secured lenders.

> True Case History: An example of the misapplication of current law may be found in the case of a bank located in Butte, Montana (one of only three banks in Butte). The site of considerable mining in the past, a great deal of the land in and near Butte has been included on the National Priorities List of properties designated by EPA as high priorities for cleanup. Prior to enactment of CERCLA, this bank made a $275,000 loan, secured by real property of the borrower, to a company which later became insolvent and defaulted on its loan. The Small Business Administration guaranteed 90 percent of the loan. After the borrower gave the bank a deed in lieu of foreclosure in 1984, the bank held the deed for less than 90 days, but it never recorded the deed and it returned the deed to the borrower (who accepted the deed and has since used the property). The Small Business Administration has declined to take the property as security for

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[1] 42 U.S.C.9601(20)(A).

its 90 percent of the loan and has not paid the bank the 90 percent guaranteed by SBA.

In early 1990, the bank received a special notice letter from the Montana Department of Health and Environmental Sciences (designated as the lead enforcement agency) which informed the bank of its liability as a potentially responsible party (PRP) for cleaning up the property which had served as security for this loan. There is no allegation that the bank caused or contributed to any of the contamination at issue. There is one other PRP with assets to contribute to this cleanup, and parties are looking to the bank to pay half the clean up costs.

Current estimates of cleanup costs exceed $10 million dollars. This bank currently has assets of $32 million and unrestricted capital of $425,000. Thus, the bank made a loan on which it expected its risk to be $27,500 (the 10 percent of the original loan amount not guaranteed by the SBA), and it is now facing the possibility of liability for at least $5 million, over ten times its unrestricted capital.

Obviously, this liability has the potential to destroy this community bank. This bank has served as a source of capital for many businesses in the community for many years.

JUDICIAL MISINTERPRETATIONS DEFEAT CERCLA'S GOAL OF ENCOURAGING PRIVATE CLEANUP OF CONTAMINATED PROPERTIES

When CERCLA was enacted in 1980, one of its central purposes was to shift to the private sector the cost of cleaning up contaminated properties. As a matter of public policy, to discourage lenders from making loans secured by properties with contamination cuts off the financing which is essential to accomplishing one of CERCLA's primary purposes. With today's budget difficulties at all levels of government, government funds simply are not available pay for cleanup of the many contaminated sites in this country. At present, there are 1,189 sites on the National Priorities List,[2] and another 34,793 sites on the CERCLIS list[3] of properties to be considered for the National Priorities List. In 1989, EPA estimated the average cost of cleanup at $25 million per site and predicted that this average was likely to increase.[4] Cleanup costs and other damages under CERCLA can far exceed the amount of a lender's loan and the value of the property securing the loan.

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[2] 56 Federal Register 5598, February 11, 1991.

If we, as a nation, wish to clean up our country's environment and rid ourselves of contamination, our government should encourage, rather than discourage, private lenders to make financing available to foster cleanup. Judicial interpretations of CERCLA are having the opposite effect.

Judicial Erosion of Secured Creditor Exemption

Before 1986, secured lenders could assess the outside limit of their risk in making a loan, and foreclosure provided a reliable remedy to offset the loss caused by default.

In 1986, a lender who foreclosed and purchased a property at a foreclosure sale was first held liable under CERCLA as an owner of the foreclosed property, notwithstanding the Secured Creditor Exemption, in the case of U.S. v. Maryland Bank and Trust,[5]. Environmental liability can far exceed both the amount of a loan and the fair market value of the collateral at the time of origination. Since the Maryland Bank and Trust decision, lenders have been unable to quantify the limit on their risk except if they abandon the traditional remedy of foreclosure, thereby avoiding ownership and the CERCLA liabilities of an owner; only in this way, can a

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[3] As of June 10, 1991, according to information received by calling EPA's RCRA/Superfund Hotline.

[4] Reilly, William K., Administrator, U.S. Environmental Protection Agency, "A Management Review of the Superfund Program," June 1989.

[5] 632 F.Supp. 573 (D. Md. 1986).

lender limit its loss to the amount of the unpaid principal, interest and costs incurred. The situation is exacerbated for the large number of commercial real estate loans which are made without recourse[6] because with non-recourse loans a lender who declines to foreclose is left with essentially nothing.

From the Maryland Bank and Trust decision until recently, lenders have been forced to make the choice between an outside limit on their risk and exercising their foreclosure rights. However, in 1990, the Eleventh Circuit sent shock waves through the real estate lending community in the first federal appellate court decision interpreting the Secured Creditor Exemption, U.S. v. Fleet Factors.[7] In Fleet, the Eleventh Circuit held a lender liable who did not foreclose on the real property securing the loan (but did foreclose on the personal property collateral). The Fleet decision exacerbated the risks of lenders by its dicta that the mere capacity to influence a borrower's disposal of hazardous substances would be enough to trigger CERCLA liability. Moreover, the court explicitly declined to follow the holding in U.S. v. Mirabile[8] that lenders could become involved in financial operations of the borrower without participating in the management of a property sufficiently to trigger CERCLA liability.

The Fleet decision may have the effect of forcing lenders to choose between acting prudently and risking CERCLA liability. For example, generally when a borrower defaults on a loan, it is prudent lending practice for the lender to work with the borrower to try to salvage the loan. Normal workout activities often involve changes in the financial operations of the borrower, many of which may be recommended or required by the lender as a condition of forbearing to enforce the loan. Yet under the reasoning in *Fleet*, those practices could be interpreted as participating in the management of the facility, thus triggering CERCLA liability. Moreover, lenders ordinarily require loan documents to provide broad powers to lenders, often including the power to require borrowers to handle hazardous substances in accordance with applicable laws. According to the standard expressed in *Fleet*, this very power, even if unexercised, would trigger liability for the lender.

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[6] Loans without recourse are loans in which the lender has no recourse against the borrower for any value not recovered upon foreclosure or its equivalent, e.g. acceptance of a deed in lieu of foreclosure.

[7] 901 F.2d 1550 (11th Circuit 1990).

[8] 15 ELR 20994 (E.D. Pa. 1985).

After *Fleet*, a lender's most protective stance against CERCLA liability is to do nothing at all: not to foreclose on a loan in default, which may trigger liability as an owner; not to act as a prudent lender by attempting to salvage a loan in default, which may trigger liability as one who participates in the management; not to have loan documents which require the borrower to handle hazardous substances responsibly because that demonstrates the capacity to control the disposal of hazardous substances, which may trigger liability as one who participates in the management; and certainly not to enforce any requirements for the borrower to handle hazardous substances responsibly, which may trigger liability under the *Fleet* standards. By carefully refraining from any action, the lender may forfeit unpaid principal and interest but may protect itself against catastrophic liability exceeding these amounts.

For a lender to a refrain from requiring a borrower to handle hazardous substances responsibly, or to refrain from allowing itself the option of imposing such a requirement on a borrower, fails to serve CERCLA's goal of encouraging private cleanup of contaminated sites.

Moreover, notwithstanding that inaction offers protection against CERCLA liability, it is rare for a lender to take no action at all when a borrower defaults, and it is unrealistic for lenders not to incorporate in their loan documents some provisions requiring borrowers to handle hazardous substances responsibly. Instead, lenders are often hoping for the best and taking the risk of liability by trying to work with borrowers to salvage loans.

Commercial real estate loans originated since 1986 often authorize lenders to require or perform an environmental assessment of a property. With information about the condition of a property, a lender can make a more informed choice between the risk of CERCLA liability and losing its investment by refraining from action. However, there are many loans in existing portfolios that were originated before 1986; these loans often do not allow a lender to conduct an environmental assessment and rarely (if ever) had environmental assessments upon origination. In fact, some state laws prohibit a lender from entering upon a property for any reason, even to perform an environmental assessment, without current borrower consent, notwithstanding that the loan documents authorize the lender to do so. When an environmental assessment cannot be performed, a lender is forced to make an uninformed decision about whether to risk working out or foreclosing on a loan.

Limitations of the Innocent Landowner Defense

Yet another provision of the law, the Innocent Landowner Defense, has had a similar effect of discouraging lenders from making loans to clean up contamination. Enacted in 1986 with the laudable goal of providing a defense to those who acquire properties without knowing for a person who acquires property after disposal of the hazardous substances and who, at the time of acquisition of the property, did not know and had no reason to know that any hazardous substance was disposed of on the property.[9] In order to establish that a party has no "reason to know," the party must show that at the time of acquisition of the property it made "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice."[10]

If a borrower were to approach a lender for a loan to clean up contamination, the lender could not make the loan and also qualify for the Innocent Landowner Defense because the lender would clearly have known about the contamination before the loan was made. This restriction would apply even if the borrower were innocent of causing any contamination itself (for example, if the borrower were the victim of a midnight dumper). The restriction would also apply if the lender already held the borrower's note in its portfolio and the borrower would be forced into default on the existing debt if forced to pay cleanup costs without additional financing.

Opponents of S. 651 and similar legislation have challenged the need for a clarification of the Secured Creditor Exemption because lenders (as well as others) can plead the Innocent Landowner Defense. However, the usefulness of the Innocent Landowner Defense has itself been questioned, and one EPA lawyer charged with enforcing EPA's guidelines regarding this defense has been quoted as stating that:

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[9] 42 U.S.C. 9601 (35)(A)(i).

[10] 42 U.S.C. 9601 (35)(B).

> Thus the bottom line on the new 'innocent landowner defense' is that very few 'innocent' subsequent purchasers of contaminated property are going to be found. Prudent investors in real property, especially commercial property, will inquire about environmental problems early and often.
>
> EPA may or may not be sympathetic to claims from parties who fit the statutory definition of potentially responsible party, but in the end, sympathy does not clean up contaminated property.[11]

One critical problem with the Innocent Landowner Defense is that no one knows what inquiry is appropriate to qualify for the defense. This uncertainty has spawned countless and conflicting articles purporting to have the one correct version of a Phase I environmental assessment and has caused considerable concern and confusion in the industry. Consequently, an effort is underway through the American Society of Testing and Materials to define environmental due diligence in commercial real estate transactions for purposes of qualifying for the Innocent Landowner Defense. Initiated in March of 1990, the ASTM Subcommittee conducting this effort has over 500 members, including an active lenders group, and is engaged in difficult negotiations. Its Chairman optimistically hopes for a standard to be issued this year. Representatives of the Section on Real Property, Probate and Trust Law of the ABA, including myself, are actively participating in this ASTM process because of the importance of resolving uncertainties regarding the definition of environmental due diligence in commercial real estate transactions.

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[11] Helen Keplinger, EPA, 18 Chem. Waste Lit. Rep. 856, cited in Italiano, M. and Jones, R., "A National Effort Underway to Develop Standards for Due Diligence in Commercial Transactions," 5 Toxics Law Reporter (BNA) 78, 80 (June 13, 1990).

CONTINUED NEED FOR ENVIRONMENTAL ASSESSMENTS

Opponents of legislation such as S. 651 argue that lenders will stop conducting or requiring environmental assessments if they are not ultimately liable for cleanup costs. S. 651 includes a specific affirmative obligation for environmental due diligence.

Even if legislation were not to include such an affirmative obligation, this argument ignores the realities of the commercial real estate market. Secured lenders make loans secured by the value of real and personal property. If contaminated, the value of that property is likely to erode. No lender wants to make a loan in which the value of the collateral is, or may become, less than the amount of the loan. If S.651 is enacted, borrowers, as owners or operators of properties, will remain liable. A lender depends on the borrower's ability to repay the loan. If the borrower is confronted with unanticipated cleanup costs, its ability to repay the loan is undermined. Moreover, even if a lender were not liable for cleanup costs, if it were to foreclose on a contaminated property it is unlikely that a lender would find a buyer willing to purchase the property with its accompanying liabilities for cleanup costs.

Thus, if S. 651 were to be enacted even without the affirmative duty for environmental due diligence, lenders would still have considerable incentive to continue to require environmental assessments in connection with commercial loan originations.[12]

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[12] While environmental assessments are often performed in commercial and industrial real estate loan transactions, a substantial minority of commercial and industrial loan transactions have no environmental assessments upon origination. A survey conducted in the fall of 1989 on behalf of Boelter Associates by Shugoll Research and Jaffe Associates, found that nearly thirty percent of recent real estate loans secured by commercial and industrial properties had no environmental assessments on origination. The same study found that in recent transactions of under $2 million each, at least forty-two percent of real estate loans secured by commercial and industrial properties had no environmental assessments upon origination.

DRAFTING CONCERNS

ABA's policy calls for clear and predictable guidance from Congress and the EPA on the Secured Creditor Exemption. S. 651 is an excellent vehicle to provide such guidance. Nevertheless, even in S.651, several issues require clarification. For example in Section (a)(1) and (2), the meaning of the term "actual benefit conferred" by a removal, remedial, or other response action is not clear. With your permission, we would like the opportunity to work with your staff on drafting clarifications.

THE PROBLEM EXACERBATES THE CREDIT CRUNCH

It should be pointed out that the problem of lender liability under CERCLA is not just a lender problem but also a consumer problem and a general economic problem. It is no news to the Senate Banking Committee that businesses in our country are finding it increasingly difficult to obtain financing and that this credit crunch is contributing to our current recession.

The specter of catastrophic liability under CERCLA for lenders who are innocent of causing contamination contributes to the credit crunch by having a chilling effect on lending to many types of businesses, particularly businesses such as gas stations and dry cleaners which provide services needed by most citizens.

In fact, many groups representing borrowers are actively supporting legislation to restore the Secured Creditor Exemption to CERCLA because it exacerbates the credit crunch currently crippling our economy. Such groups include the International Council of Shopping Centers, the National Realty Committee and the National Association of Home Builders.

II. FIDUCIARY ISSUES UNDER CERCLA

SUMMARY

The nature and extent to which CERCLA applies to parties to a fiduciary relationship is disturbingly unclear. These uncertainties need to be resolved by statute or regulation; otherwise, they will result in years of expensive and protracted litigation. Uncertainties as to the correct application of CERCLA will also force fiduciaries to settle cases where the fiduciary should have prevailed, shifting costs from polluters to insured institutions, charitable and individual beneficiaries, and other innocent parties. The normal response to uncertainty under a strict liability system is to do everything feasible to comply with the strictest conceivable interpretation. This response is likely to cause insured institutions[13] to incur fiduciary liability for breaching the duty of loyalty owed to beneficiaries, including liability for punitive damages. Fiduciaries will inevitably make errors of judgment in attempting to reconcile the conflicting and uncertain mandates of their duties under CERCLA and their fiduciary duties, particularly when such judgments are reviewed with the benefit of hindsight. Furthermore, over-zealousness is often forgiven when the fiduciary is a family member, but history has shown that insured institutions are held to a higher standard and are not typically sympathetic defendants.

At the present time, and in view of the critical uncertainties, the only way for a fiduciary to clearly avoid CERCLA related liability is to exercise its right to refuse to serve as a fiduciary where CERCLA could be applicable. It would be better to keep qualified and knowledgeable professional fiduciaries as a part of those helping to carry out the objectives of CERCLA, which can be done through clarifying the bases of liability and affirming that an innocent fiduciary will not be held liable.

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[13] This testimony focuses on the problems of insured institutions, which is the issue before this Committee; however, the American Bar Association urges Congress to address these problems for all corporate and individual fiduciaries.

INTRODUCTION

Although many parties have been subjected to liability and threatened liability in the decade since CERCLA was enacted, increasing concern has recently been expressed with respect to the imposition of liability upon executors, administrators, trustees, estates, trusts, heirs and beneficiaries. In current litigation, private parties, as well as government agencies, have sought to hold one or more of these parties liable for environmental damage, even though that damage started years or even decades ago. Such liability is asserted even though neither the fiduciary nor its predecessors caused or contributed to the pollution. In some cases these parties have received or been threatened with orders to clean up a site. In other instances, the EPA and private parties, after undertaking cleanup, have sought reimbursement from the fiduciaries and their beneficiaries.

THERE IS A SERIOUS PROBLEM DUE TO UNCERTAINTY

With respect to insured institutions, the primary focus to date has been upon potential liability arising out of lending and security arrangements. However, public awareness and concern[14] are increasing with respect to the potential unlimited environmental liability of trustees, executors, administrators and guardians (collectively, "fiduciaries") in situations where they have neither caused nor participated in the environmental contamination.

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[14] Indeed, it is fair to say that, on occasion, concern has given way to panic.

The problem arises because insured institutions and others serving as fiduciaries are almost completely without guidance as to the application of CERCLA to fiduciaries.[15] When someone dies, executors and perhaps trustees are required to administer and manage the decedent's properties. However, the insured institution serving as the fiduciary (and often relied upon by the surviving spouse and young children) cannot determine the nature and extent of its duties and potential liability with respect to environmental issues, particularly if the decedent owned real property or a closely held business.[16] The prospective fiduciary is told by its counsel that CERCLA does not specifically address the issues that are of the most immediate concern, and that it is very difficult under CERCLA to determine by analogy how those issues will be resolved. Thus the insured institution is being asked to qualify and begin serving without being able to make a realistic evaluation of the potential for incurring corporate liability if environmental problems are identified. Prospective fiduciaries are understandably reluctant to voluntarily assume a fiduciary duty where the maximum benefit is limited to the amount of a reasonable fee and the potential "down side" is a significant risk of incurring unlimited corporate liability for environmental cleanup of properties in which the fiduciary does not own a beneficial interest.

Fiduciaries are in an *unusually* difficult situation under CERCLA. A fiduciary is not spending its own money, and its fiduciary duty to the beneficiaries prohibits it from spending the beneficiaries' money for a public benefit unless clearly required to do so.

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[15] A technical discussion as to what makes CERCLA so uncertain with respect to fiduciary relationships is below.

[16] The utility of the "inheritance defense" to CERCLA liability in such situations is limited and uncertain.

Accordingly, fiduciaries find themselves required to reconcile two systems that are in inherent conflict. A fiduciary owes to its beneficiaries a duty of loyalty, and cannot serve other interests to the detriment of the beneficiaries' interest. The duty of loyalty typically focuses on the beneficiary's *economic* interests, and except where a contrary legal obligation is clearly imposed on the fiduciary, all expenditures made by the fiduciary must be in furtherance of the economic interests of the beneficiary. In virtually every other situation where the law imposes a duty on a fiduciary that is contrary to the economic interests of the beneficiaries, the inherent conflict is resolved by clearly articulating the compliance requirements imposed on the fiduciary. Using the example of the reporting and collection of taxes, the scope of application and the rules for compliance are carefully articulated to make it clear to the fiduciary what it must do to comply with the obligation imposed by law and avoid corporate liability. It is well established that actions by the fiduciary which are necessary to comply with the law are not a breach of the fiduciary's duty of loyalty to its beneficiary. Accordingly, it is not a breach of the fiduciary's duty of loyalty to the beneficiary for the fiduciary to pay taxes that are properly assessed on the fiduciary estate. On the other hand, it would be such a breach for the fiduciary to send in an extra $100 with the tax payment to reduce the federal debt.

But CERCLA stands in stark contrast. While a fiduciary cannot be certain what it must do to avoid liability under CERCLA, it is clear that if the fiduciary does too little it faces unlimited corporate liability under CERCLA. If it does too much it faces the assertion of unlimited corporate liability, including potential liability for punitive damages, for breaching the duty of loyalty owed to the beneficiaries. Given these two liability structures, each pressing from a different direction, and without appropriate guidance with respect to the requirements of

CERCLA, fiduciaries are between the proverbial rock and a hard place. At best, it is very difficult for fiduciaries to know what they need to do to avoid liability. At worst, there are situations in which a fiduciary finds it practically impossible to conduct itself in a manner that will not give rise to liability under either CERCLA or fiduciary law, and perhaps both.

> True Case History No. 1. A large estate owns many pieces of real property of a type on which contamination is sometimes found. An inspection did not find any evidence of contamination. When the administrator announces that it is ready to distribute the property to the estate beneficiaries, two groups of beneficiaries each threaten to sue the administrator. One group of beneficiaries asserts that the administrator has a duty to inspect and to clean up any contamination on the properties before they are distributed to the beneficiaries. The other group of beneficiaries asserts that the administrator is without authority to so "waste" estate assets when the previous inspections did not find contamination. The administrator's duties in this situation are not clear.

THE CONSEQUENCES OF UNCERTAINTY

Failure to resolve the key environmental issues that arise in a fiduciary context will almost certainly give rise to two major consequences. First, fiduciaries, particularly sophisticated insured institutions, will generally decline to serve in situations where significant environmental problems are suspected. Second, insured institutions serving as fiduciaries will incur liability in situations where they decide to serve and the environmental problems were not appreciated in time to avoid liability.

Avoiding CERCLA. To minimize CERCLA related liability, the bar typically advises fiduciaries to avoid situations where liability may arise. That advice is widely given, and many fiduciaries are following it. Before these fiduciaries accept a fiduciary appointment, they conduct at least an initial environmental review of the prospective fiduciary estate's real property and businesses, and then decline to serve if significant environmental problems are suspected.

Conducting environmental reviews before accepting fiduciary appointments may seem unremarkable to many acquainted with CERCLA. Transferees of commercial and industrial property often conduct environmental reviews before property is transferred to them in hopes of taking advantage of the Innocent Landowner Defense under CERCLA. However, such reviews generally have no social utility with respect to involuntary transfers of property.

Fiduciary relationships most often arise in situations where the transfer is involuntary due to circumstances beyond the control of the parties, such as death. Because "you cannot take it with you," death results in a transfer that will not wait for environmental problems to be discovered and remedied. Inspecting property for environmental problems may affect whether a particular fiduciary will serve, but it will not change the necessity for some fiduciary to serve.

The threat of imposing personal liability on fiduciaries for environmental problems, without any clear guidelines as to how that liability can be avoided, works contrary to the goal of accomplishing speedy cleanups. It encourages sophisticated and qualified fiduciaries to avoid those situations where an environmental problem may exist. In such situations, the only fiduciaries willing to serve may be those who are less sophisticated, less qualified and thus less likely (whether unintentionally or intentionally) to comply with environmental laws.

Another unfortunate consequence may exist of threatening to impose personal liability on fiduciaries for environmental problems without being clear how that liability can be avoided: the needless failure of closely held businesses after the death of a key person. This greater rate of failure may occur as sophisticated and qualified fiduciaries are reticent to undertake responsibility for administrations involving closely held businesses where theoretical operational control (and potential "operator" or "arranger" liability) arises long before there is any actual ability to evaluate and control operations. Such reticence may result in the failure of businesses struggling to adjust to the loss of key persons, and these avoidable failures will result in the loss of capital and jobs to the economy. Failure also diminishes the ability of such businesses to pay their obligations to insured institutions and their environmental obligations.

Incurring Liability. Despite the desire, fiduciaries cannot always avoid serving when significant environmental problems exist and will incur liability when environmental problems are not appreciated in time to avoid them. Accordingly, fiduciaries face years of expensive and protracted litigation with respect to CERCLA related matters before clear answers will emerge. On one side, the EPA and third parties may claim that the fiduciary did not do enough. On the other side, the beneficiaries may claim the fiduciary did too much, too soon, and acted not to protect the beneficiary, but to protect the fiduciary's individual liability in the face of uncertainty as to the nature and extent of required compliance with CERCLA. Large sums of money will be spent on litigation, and the uncertainties will often force fiduciaries to make substantial payments to settle cases that the fiduciary should have won, shifting costs from the polluter to insured institutions, charitable and individual beneficiaries, and other innocent parties. The combination of CERCLA liability and fiduciary liability should be expected to cause the failure of some insured institutions, resulting in unnecessary losses to the public fisc and loss of banking and ancillary services to the community.

WHY THERE IS UNCERTAINTY

The four classes of responsible parties that can be held liable for the costs of hazardous waste removal under CERCLA are commonly referred to as "owners," "operators," "generators" and "transporters" and are collectively known as "potentially responsible parties." As construed by the federal courts, even if the present owner or operator of a site containing hazardous substances is without fault, and had nothing to do with the pollution, joint and several liability is imposed on both that present owner or operator as well as certain former owners or operators of the site.

Owners. It is not clear which parties to a fiduciary relationship can incur liability as an "owner" under CERCLA. There are three possibilities. One possibility is that the beneficiary of the trust, who holds equitable title to each asset of the trust, might be an "owner," making all of the beneficiary's assets subject to being taken to satisfy the CERCLA liability. A second possibility is that the trust that owns the contaminated property might be treated as if it were an entity and an "owner," making all of the trust's assets subject to being taken to satisfy the CERCLA liability.[17] The third possibility is that the insured institution serving as trustee of the trust, and thus holding legal title to the contaminated property in its fiduciary capacity, might be treated as an "owner" in its corporate capacity, making all of the trustee's own assets subject to being taken to satisfy the CERCLA liability. None of the possibilities excludes the others.

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[17] Of course, a trust is not an entity, but is a division of legal and equitable title. The analysis would technically be that the trustee of the trust is an "owner" in its fiduciary capacity. But there is often a practical utility to thinking of a trust as an entity, despite the common law rule. Trusts are treated as entities for federal income and transfer tax purposes and for financial accounting purposes. It is possible that CERCLA will likewise think of a trust as an entity that is distinct from both the trustee and the beneficiary.

There is no direct statutory or regulatory authority, nor is there reported case law, as to which parties to a fiduciary relationship can incur liability as an "owner" under CERCLA. The only case found under standard research techniques which appears to have considered the issue is an unreported district court decision, *United States v. Burns*, No. C-88-94-L (D.N.H. Sept. 12, 1988) (LEXIS, Genfed library, District file). On its face, the *Burns* decision appears to be relevant to the broad issue as to whether a trustee of a trust and the beneficiary of a trust can generally be held liable as an "owner" under CERCLA. But a subsequent ruling on the merits in the case (not available on LEXIS) held that the *Burns* case did not involve an express trust, but rather actually involved an entity that, for purposes of determining the liability of its economic owners, was a general partnership under state law. Even if the *Burns* case were truly a trust liability case, the case would be of doubtful precedential value as to the liability of trustees, trusts and beneficiaries under CERCLA because:

> (i) the opinion relies on a citation to Scott, III *Scott on Trusts* §§265, 265.1 (3rd ed. 1985), that is clearly removed from its context and ignores a substantial (and cross-referenced) discussion in the same section that shows (a) the issue before the court was more complex than the court admitted and (b) the result reached by the court as to the liability of the trustee in such a case is inconsistent with the rule set forth in §265 *Restatement (Second) of Trusts* (1959);
>
> (ii) the court failed to note substantial and clear authority, discussed in the same chapter of *Scott on Trusts* cited by the court, that the defendant before the court was liable on an agency theory, as opposed to being liable simply because he was a trustee or beneficiary; and

(iii) it appears that the full implication of the trust law issues that would have been before the court (assuming the case had been a trust case and the facts were as recited by the court), such as the doctrine of merger, were not recognized by the court.

Regardless of the *Burns* case, a strong argument can be made under existing trust law principles that:

(i) the trustee of a trust in its *corporate (or individual)* capacity should not be held liable under CERCLA as an "owner" with respect to property that the trustee only owns in its *fiduciary* capacity;

(ii) the beneficiary of a trust should not be held liable under CERCLA as an "owner" with respect to property in which the beneficiary owns a beneficial interest, except in situations where the trustee of the trust is the agent of the beneficiary; and

(iii) the trustee of a trust in its *fiduciary* capacity (which is commonly thought of as "a trust") can be held liable as an "owner" with respect to property that the trustee owns in its *fiduciary* capacity.

Although the above positions regarding "owner" liability under CERCLA as integrated with trust law principles can be argued, the absence of direct authority under CERCLA leaves parties to fiduciary relationships in a very precarious position. The *Burns* case is commonly cited in articles for the proposition that a trustee is liable under CERCLA as an owner solely because a trustee is the legal owner of property, not recognizing the distinction between a trustee's corporate capacity and its fiduciary capacity. Given the magnitude of liability, trustees in their corporate capacity and beneficiaries will find themselves in CERCLA cases defending against the assertion of liability on the theory that they are "owners" for purposes of CERCLA. Trustees in their corporate capacities and beneficiaries will have to litigate these issues before they are authoritatively resolved by the courts. Worse, the courts may hold that (i) the trustees in their corporate capacities, (ii) beneficiaries, or (iii) both, are liable as "owners" under CERCLA, perhaps "following" the *Burns* case.

Turning from trustees to personal representatives, an executor or administrator of a decedent's estate ("the personal representative") should not be treated as an "owner" of contaminated property under the laws of most states, which typically provide that the personal representative does not own title to real property that is subject to administration by the personal representative.

Operators and Arrangers. Even if fiduciaries avoid being liable as "owners" under CERCLA, they still face the prospect of being held liable under CERCLA in their corporate (and individual) capacities as "operators" or as "arrangers."[18] As a practical matter for fiduciaries, there is no statutory authority, regulatory authority or reported case law as to the scope of either "operator" or "arranger" liability under CERCLA. In a corporate context, courts have held that certain individuals acting on behalf of a corporation can be held liable under CERCLA as "operators" or as "arrangers," but consistent rules of decision have not yet developed.

There is no reason to doubt that in some situations a fiduciary may be held liable as an "operator" or as an "arranger," but there is virtually no guidance as to what situations may give rise to liability. The only way that any responsible advice can be given to fiduciaries is to draw analogies from the corporate context. Although the case law that has developed in a corporate context is still unsettled, it seems to be evolving that "operator" status or "arranger" status will only be imposed on corporate managers who knew of the environmental hazard, or clearly should have known, and failed to take appropriate action. However, courts may be willing to impose "operator" or "arranger" liability on managers that did not cause or contribute to the release of a hazardous substance. *See, e.g., New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d. Cir. 1985)(corporate officer and stockholder held liable under CERCLA as an "operator" where the individual knew of the hazardous substances before he had his corporation acquire the property, although it is not clear from the court's opinion that the individual caused or contributed to the release). Fiduciaries would seem to be at a significant risk of becoming "operators" or "arrangers" when a fiduciary estate owns either a controlling interest in a closely held business that generates hazardous substances or a controlling interest in contaminated real property.

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[18] Liability as an "operator" and liability as an "arranger" are very different categories under CERCLA, but both categories pose the same problems of uncertainty for fiduciaries.

Given the lack of authority regarding fiduciary "operator" and "arranger" liability, fiduciaries have no way to know what they must do to avoid "operator" or "arranger" liability. As the EPA and other plaintiffs look for potentially responsible parties, fiduciaries find themselves defending against assertions that the term "operator" or "arranger" should be read *very* broadly for purposes of imposing CERCLA liability on a fiduciary in its corporate capacity.

> True Case History No. 2. The EPA has requested a trustee to pay several million dollars to fund the cleanup of a Superfund site. Several years before CERCLA was enacted, the trustee accepted a trusteeship for a trust that needed its interest in some closely held corporations sold. During the eighteen months before the sale, an employee of the trustee served as one of three corporate directors. She was never involved with any decisions made regarding hazardous substances. The other two directors were officers of the corporation. The EPA's request is based upon the

> **theory that the trustee became an "arranger" by allegedly managing the operations of the corporations.**

CONCLUDING COMMENTS

A Loophole? There is a concern that addressing the problem discussed in this testimony will open a loophole in CERCLA or cause the loss of funds that should otherwise be available for cleanup. A careful examination of this issue is beyond the scope of this testimony; however, an analysis that concludes that the concern is illusory can be found in Graham and Lindquist, "Fiduciaries and CERCLA," ***Environmental Law in the Fiduciary Context***, **American Bar Association, Section on Real Property, Probate and Trust Law (Spring CLE Mtg. 1991), a copy of which has been provided to the staff of the Committee.**

III. CONCERN BY ABA'S REAL PROPERTY, PROBATE AND TRUST SECTION

These issues have been the subject of considerable concern by ABA's Real Property, Probate and Trust Section. There are two Divisions of this Section: the Real Property Division and the Probate and Trust Division.

Shortly after the Maryland Bank and Trust decision, the Real Property Division established an Environmental Committee to address problems of environmental liability in real estate transactions, including financing transactions. Over the past five years, several additional Subcommittees have been formed. In addition, Probate and Property, the periodical of the Real Property, Probate and Trust Section, has published several articles, including two of mine on these issues: "Environmental Liability Risk Management" in January/February 1989, and "An Update on Environmental Liability," co-authored by Evelyn L. Ochman, in January/February

1991. The Real Property Division has sponsored many panels and seminars on these issues over the last several years.

Fiduciary issues are receiving greater attention and concern daily, especially by the Probate and Trust Division of the Real Property, Probate and Trust Section. During the past year, continuing education programs for trust officers and attorneys on environmental concerns of fiduciaries have been among those most heavily attended. In response to these concerns, the Environmental Problems of Fiduciaries Committee (Michael L. Graham, Chair) has been formed by the Probate and Trust Division.

IV. NEED FOR LEGISLATION
IN LIGHT OF
EPA's PROPOSED RULES ON LENDER LIABILITY UNDER CERCLA

Legislation is needed even if EPA promulgates a final rule substantially similar to the draft it released on June 5, 1991 regarding the "National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA" (the "Proposed Rule"). While ABA's policies address only liability under CERCLA, S.651 addresses strict liability under any Federal law imposing strict liability for the release of a hazardous substance at or from property.

Fiduciaries

Legislation is necessary because of all the uncertainties described in this testimony regarding liability of fiduciaries under CERCLA. EPA's Proposed Rule does not address the problems of liability of innocent fiduciaries under CERCLA, whereas S.651 addresses these troublesome issues.

Leasing Arrangements

Legislation is also necessary because the Proposed Rule does not adequately address situations in which parties are referred to as lessors when in reality their function is equivalent to that of a secured lender.

Secured Lenders

With regard to secured lenders who are innocent of causing contamination, the Proposed Rule fulfills some of the recommendations of the ABA's policy on the Secured Creditor Exemption, and the EPA and other agencies involved are to be commended for their work in producing a substantial step forward.

Notably, the Proposed Rule in some ways meets ABA's recommendation that EPA should exercise its rulemaking authority to provide further clarification (but not greater than required by statute) regarding the actions which lenders are required to take in order to be afforded the benefits of the Secured Creditor Exemption. In some ways, it also meets ABA's recommendation that EPA regulations should provide clear and predictable guidance with respect to existing loan portfolios, new loans, loan administration, including sufficient time in enforcement and remedies, and with respect to the secondary mortgage market.

While not without room for improvement, the Proposed Rule provides some bright lines for a lender to show that it is divesting itself of a property following foreclosure, rather than holding it for investment as an owner: that the property be listed with a broker, dealer or agent within twelve months following foreclosure, that the property be advertised on at least a monthly basis, and that the lender should not reject or fail to act (within ninety days) on a written, bona fide, firm offer of fair consideration for the property. (This provision was substituted for an unrealistically short and arbitrary deadline for divesting of foreclosed property in a previous draft of the rule.) Fair consideration includes outstanding principal, interest and penalties, and other necessary costs incurred by the lender.

In addition, the Proposed Rule defines activities that will not trigger CERLCA liability because they are not considered to be participating in the management of a property, including:

- undertaking or requiring an environmental inspection
- requiring a borrower to clean up the property
- requiring a borrower to comply with environmental laws and regulations
- securing authority to inspect the property
- monitoring the borrower's business or financial condition
- conducting workouts including restructuring or renegotiating the loan, giving specific or general financial advice, suggestions, counseling and guidance.

Third Parties

ABA's policy calls for legislation to address liabilities of private, as well as public, parties. The Proposed Rule attempts to provide a basis for its application to third party actions by making the rule part of the National Contingency Plan. CERCLA provides that in order to recover response costs, third parties' response costs must be "consistent with the national contingency plan."[19] Because it is uncertain how a court would view this attempt to make private, third party actions subject to the Proposed Rule, legislation is needed to clarify this issue.

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[19] 42 U.S.C. 9607(a)(B).

Protection of Congressional Intent

Legislation is necessary because the final content of an EPA rule on this issue is not yet known. Moreover, notwithstanding that regulations may be useful and may be accorded deference by the courts, regulations may be overturned by courts.[20] An egregious example of judicial misinterpreation of Congressional intent may be found in the courts' misinterpretation of the Secured Creditor Exemption cited earlier in this testimony. A clear directive from Congress would not leave the EPA's rule vulnerable to erosion by the courts similar to judicial erosion of the Secured Creditor Exemption.

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[20] In fact, a specific provision of CERCLA invites challenges to regulations as enacted (42 U.S.C. 9613(a)), and it is likely that the final version of this Proposed Rule will be subject to such a challenge.

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American College of Real Estate Lawyers
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Adopted 2/91

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AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, PROBATE & TRUST LAW
REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

BE IT RESOLVED, that the American Bar Association urges Congress and the Environmental Protection Agency to recognize the necessity for clarification of the "security interest" exemption under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and recommends to Congress and the EPA that, in order to achieve this clarification:

1. There should be reaffirmation of the principle that innocent parties should not be held liable for cleanup of environmental hazards.

2. EPA should exercise its rulemaking authority to provide further clarification (but not greater than required by statute) regarding the actions which lenders are required to take in order to allow them to be afforded the benefits of the "security interest" exemption from CERCLA liability.

3. EPA regulations, by way of definition and guidance, should acknowledge the legislative history behind the "security interest" exemption. In rulemaking, EPA should seek to establish and clarify standards which are capable of consistent and predictable application by borrowers and lenders.

4. EPA regulations and any Congressional legislation should provide clear and predictable guidance with respect to existing loan portfolios, new loans, loan administration, including sufficient time in enforcement and remedies, the secondary

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mortgage market, and responsibility and liability of entities, court appointed officers such as receivers and trustees, the FDIC, RTC and SBA.

5. To the extent that EPA regulations cannot lawfully address CERCLA liabilities incurred by both public and private response and remedial actions, Congress should provide clear legislation and guidance on this subject.

6. As changes are to be made in the CERCLA law and as rules are proposed, they should be made through an orderly legislative and administrative process with participation of all concerned parties, including hearings with adequate notice and an opportunity for parties to participate in the formulation of the new regulation or law.

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REPORT

I. Introduction:

Since the enactment, in 1980, of the Comprehensive Environmental Response, Compensation and Liability Act, often referred to as "CERCLA", or "Superfund", a myriad of parties have confronted unexpected liabilities. Numerous judicial decisions, construing CERCLA and its legislative history, including changes effected through the 1986 Superfund Amendment and Reauthorization Act, ("SARA"), have emphasized the fashion in which the legislation was enacted, and the ambiguities inherent in it.

On its face, liability under CERCLA is far reaching and ostensibly clearcut. Section 107 imposes liability on

> 1. the owner and operator of ... or a facility,
>
> 2. any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of....

Despite the seemingly clear language of the statute, there has been a significant amount of litigation regarding who is liable under CERCLA. For example, courts have ruled the following are potentially liable as "owners" or "operators" of a hazardous waste site:

a. Present owners of sites, even though their actions did not contribute to the environmental problems, *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985); *United States v.* Cauffman, 21 Env't. Rep. Cas. (BNA) 2167 (C.D. Cal. 1984).

b. A firm that acted as a conduit in the transfer of title to a site and held legal title for only one hour, *United States v. Carolawn Co.*, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20698 (D.S.C. 1984).

c. A passive owner/lessor of a site, *United States v. Argent Corp.*, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984); *United States v. South Carolina Recycling and Disposal, Inc.*, 653 F. Supp. (D.S.C.

1984) *aff'd in relevant part sub nom. United States v. Monsanto*, 858 F.2d 160 (4th Cir. 1988).

d. A passive lessee/sublessor of a site, *United States v. South Carolina Recycling and Disposal, Inc.*, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20895, 21 Env't. Rep. Cas. 1577 (BNA) (D.S.C. 1984).

e. Partners of an apparent general partnership, which partnership was the owner of a site at the time of cleanup, *United States v. Louis Serafini, et al.*, No. 86-1591, Memorandum Decision, February 19, 1988 (M.D. Pa.), 706 F. Supp. 346; 711 F.Supp. 197 (August 31, 1988).

f. Corporate officers (personally) who participate in hazardous waste disposal activities, *United States v. Northeastern Pharmaceutical & Chem. Co.*, 579 F. Supp. 823 (W.D. Mo. 1984), *aff'd in part, rev'd in part*, 810 F.2d 726 (8th Cir. 1986).

g. Shareholders (personally) of a corporation to the extent they are involved in making decisions with respect to hazardous waste disposal, *Id.*; *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665 (D. Idaho 1986).

h. Lenders who become actively involved with a polluter's activities, *United States v. Mirabile*, No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 Envtl. L. Rep. (Envtl. L. Inst.) 20994; 10 Chemical and Radiation Waste Litigation Reporter 688; *United States v. Fleet Factors Corp.*, No. CV687-070 (S.D. Ga. December 22, 1988), 724 F. Supp. 955; affirmed and *remanded*, 901 F. 2d 1551 (11th Cir., 1990).

i. A lender which takes back title through foreclosure. The United States has successfully sued a bank which foreclosed a mortgage on a "hazardous waste facility". *United States v. Maryland Bank & Trust Co.*, No. N84-4026 (D. Md. 1986), 632 F. Supp. 537. The government contended, successfully, that the bank was the "owner" of the facility and therefore subject to CERCLA liability.

Despite the broad language of section 107, CERCLA section 101(20)(A) expressly provides that the term "owner or operator" does not include "a person, who, without participating in the management of a vessel or facility, holds indicia of the ownership primarily to protect his security interest in the vessel or facility." This statutory exclusion is commonly referred to as the "security interest" exemption or exception.

Nevertheless, several cases have held that a lender's activities may take it out of the section 101(20)(A) exception, and other litigation, now underway, is seeking further to extend the scope of the lender's potential liability.

In other litigation, the government has aggressively pursued trustees, trust beneficiaries and other fiduciaries associated with contaminated property.

In one of the earlier CERCLA cases, United States v. Cauffman, (June 11, 1984, C.D. Calif.), in a ruling from the bench the Federal District Court for the Central District of California held that a trustee could be liable, under CERCLA, for actions taken on behalf of the trust.

On September 27, 1988, the United States District Court for the Eastern District of Missouri, held that statutory trustees, who were officers and directors of a corporation which was dissolved for failure to comply with annual registration requirements, were jointly and severally liable in their capacity as trustees. They were, however, liable only to the extent of the corporate property and effects which came into their possession. United States v. Bliss, Case No. 84-2086C(1), 17 Chemical Waste Litigation Reporter 1061.

In recently settled litigation, the Justice Department sought to impose liability on the beneficiaries of a Florida "land trust" for expenses in connection with cleanup and investigation of pesticide contamination. U. S. v. Tower Chemical Co., No. 85-100-Civ.-Oc-16 (M. D. Fla.), noted in 14 Chemical Waste Litigation Reporter 89 (June, 1987). In the settlement, the land trust beneficiaries agreed to pay a portion of the government's cleanup costs, and to convey the property to the government after cleanup, subject only to mortgages and liens of record before the government filed its lien against the property.

In the case of U. S. v. Burns, on September 12, 1988, the Federal District Judge refused to dismiss a CERCLA cost-recovery claim against a defendant who was a trustee of a trust that owned property that had been used as a hazardous waste site. U. S. v. Burns, Case No. C-88-94-L(D.N.H. September 12, 1988), 16 Chemical Waste Litigation Reporter 1058. Drawing upon analogies to cases involving lessees, the Court concluded that the trustee and beneficiary of the trust that owned the site could be liable as a site "owner" within the meaning of CERCLA, and therefore personal participation in waste disposal activities was not needed to establish liability.

In response to these and other cases, during 1989 and 1990, several legislative proposals were introduced, and considered during Congressional hearings, seeking to clarify and realign the CERCLA liabilities of lenders, borrowers, fiduciaries, and parties otherwise thought by some to be innocent of CERCLA liability. Moreover, late in 1990 EPA announced that it was developing an interpretive ruling which, it believed, could clarify the CERCLA liability of lenders and of quasi-governmental institutions such as FDIC and RTC.

II. Proposed Legislation:

On April 25, 1989, Representative LaFalce, introduced H.R. 2085, which, if enacted, would have provided protection from CERCLA liability for "innocent lenders" which acquire ownership or control of a property "to realize on a security interest". The proposed legislation would also afford protection to a corporate fiduciary which otherwise might have CERCLA owner or operator liability.

On June 28, 1989, Representative Curt Weldon introduced H.R. 2787, the "Innocent Land Owner Defense Amendment of 1989." The legislation, if enacted, would more clearly define the steps which must be taken to qualify for the innocent land owner defense created under SARA.[1]

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[1] Under the proposed legislation, a purchaser would be exempt from CERCLA liability if it completed a review of the chain of title for the property, investigated historical data (such as maps and photographs) to identify the prior ownership and uses of the property which might indicate the possibility that environmental contamination exists, and reviewed "reasonably ascertainable" public information, for example, government records identifying regulated hazardous waste sites and hazardous site conditions identified by federal, state or local agencies.

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Both of these legislative proposals were referred to the House Energy and Commerce Committee for consideration. The House Small Business Committee conducted hearings on the LaFalce proposal on August 3, 1989.

On April 4, 1990, Representative LaFalce introduced H.R. 4494, revising the legislation which he had proposed in 1989. Under the new proposal, the class of lenders which would be exempt from CERCLA liability, and the categories of fiduciaries which would also be exempt, were both expanded.

Earlier in 1990, concern over the impact of CERCLA liability on the Federal Resolution Trust Corporation and similar entities responsible for disposition of insolvent savings and loan associations, prompted the introduction of further legislation in both the House and Senate. In the House of Representatives, on February 22, 1990, Representative Silvio Conte from Massachusetts introduced the Federal Custodial Responsibility Protection Act of 1990, H.R. 4076, which if enacted would amend Section 101(20)(a)(iii) of CERCLA to include a federal department, agency, or instrumentality in the exempted definition of what does not constitute a "owner or operation" for purposes of CERCLA liability. The exemption would apply in any instance when title or control was conveyed due to bankruptcy, foreclosure, abandonment or tax delinquency. The legislation was referred to the House Committee on Energy and Commerce.

Similarly, Senator Jake Garn, on March 22, 1990, introduced S. 2319, which in general would provide an exemption from CERCLA liability for a mortgage lender or depository institution that acquired property in a foreclosure sale, or which was serving in a fiduciary capacity. The legislation was referred to the Committee on Environment and Public Works. The legislation takes an approach somewhat different from Representative Conte's, in that rather than amending CERCLA, instead it would amend the Federal Deposit Insurance Act and the Federal Credit Union Act.

Representative LaFalce's proposal H.R. 4494, obtained 270 to 280 co-sponsors. It would have amended CERCLA's definition of "owner or operator" to exclude "designated lending institutions" which acquired ownership or control pursuant to the terms of a security interest. The legislation would not offer exemption to a lender which "caused or contributed to the release or threatened release of a hazardous substance".

Senator Garn's legislation was revised and reintroduced as S. 2827, on June 28, 1990. Again, this was legislation to amend the Federal Deposit Insurance Act. The Garn legislation provided:

> "No insured depository institution or mortgage lender shall be liable under any law proposing strict liability for the release, threatened release, storage or disposal of hazardous or potentially dangerous substances from property (1) acquired through foreclosure; (2) held in a fiduciary capacity; or (3) held, controlled or managed pursuant to the terms of extension of credit."

Protection would be available for a lender both before and after foreclosure.

Like the proposed LaFalce legislation, S. 2827 would deny lender liability exemption to a party causing a release or threatened release, and also to a party with "actual knowledge of the presence of hazardous substances" if that party failed to take "reasonable actions" necessary to prevent a release. Legislation would also deny those lenders which benefited from a removal, remedial or government response action, the benefit of any increased value resulting from the cleanup.

Both the Garn and LaFalce proposals would also cover leasing arrangements where those were entered into as equivalent to a commercial extension of credit. They also would both provide some, but not total, protection to fiduciaries.

Hearings were held on the LaFalce proposal, by the House Committee on Small Business, on June 7, 1990. On July 19, 1990, the Committee on Banking, Housing and Urban Affairs of the Senate, conducted hearings on S. 2827. The House Subcommittee on Transportation and Hazardous Materials, on August 2, 1990, also conducted hearings to consider the LaFalce proposal. During this August hearing, the United State Environmental Protection Agency reversed its prior opposition to "piecemeal" amendments to CERCLA, and instead took the position that it would not oppose amendments addressing lender liability if they included certain safe guards. EPA requested the following:

(a) Lenders would be expected to act "prudently with regard to making loans" including "requiring investigations into the condition of the property and cleanups when appropriate"; and

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(b) Once a lender has acquired title through foreclosure, a lender on discovery of contamination would be expected to act reasonably and to exercise "appropriate care upon learning of contamination so as not to exacerbate the contamination or jeopardize public health and safety"; and

(c) If EPA Superfund/CERCLA funds are used to clean up or investigative property, the lender would be expected to share, from its sales proceeds, to provide some compensation to the Fund."

With the adjournment of Congress in October, 1990, no action occurred this Session on any of these legislative proposals. At the end of the 1990 Session of the 101st Congress CERCLA was reauthorized for several years. Although none of these proposals were included in that reauthorization, Congressional sponsors have indicated that comparable legislation will be introduced, and considered, early in the 102nd Congress.

III. Proposed Rulemaking:

During Congressional hearings on the LaFalce and Garn proposals, representatives of RTC, FDIC, SBA, and other government agencies expressed concern about the impact of CERCLA liabilities on these entities' primary responsibilities. In addition, in response to the Fleet Factors decision of the Eleventh Circuit, 901 F. 2d 1550 (1990), EPA during the August, 1990 Congressional hearings also announced its intention to promulgate an interpretive regulation designed to further define the "security interest exemption", as well as to clarify the treatment to be given public and private lenders and comparable federal agencies. The EPA regulation has not yet been officially released, however, the Wall Street Journal on October 10, 1990 published a summary of the proposal.

The proposed EPA regulation contains several provisions:

(a) Before making a secured loan, the lender would be required to obtain an environmental assessment;

(b) During the time of loan administration, loan workout and foreclosure, the regulation would provide protection against the imposition of CERCLA liability (this regulation, if implemented in this fashion, would therefore appear to reverse earlier decisions such as U.S. v. Maryland Bank) 632 F. Supp. 573 (1986);

(c) If EPA spends CERCLA monies cleaning up a portion of the collateral, then EPA expects to recover from sales proceeds the difference between the value of the property as contaminated, and the value after cleanup;

(d) The lenders interest in the property must be restricted to collateral to secure repayment of a debt, and the protection will not extend to a lender's "investment" in property;

(e) Lending institutions which act as trustees, or as property managers, would not be protected by the proposed EPA regulation.

Although EPA would be authorized to issue an "interpretive rule" without public comment, EPA has announced it intends to take comments for sixty (60) days, beginning with the official day of rule publication and release.

According to published reports, the draft regulation has been submitted to the Office of Management and Budget for review and approval. Unofficial versions have been published in several environmental reporting services. Based on those, comments have been made to EPA and to the Department of Justice, by counsel involved in CERCLA litigation throughout the country, asserting that neither EPA nor the Justice Department has the lawful authority to promulgate an interpretative regulation on this subject which would be binding on private litigants.

IV. Prior Section and ABA Action:

The Section and ABA have previously taken some action with respect to these proposals. In October, 1989, the Section received Blanket Authority authorization with respect to a portion of H.R. 2085, Representative LaFalce's original proposal, dealing with fiduciary liability. At that time the Section took no position with respect to the other elements of H.R. 2085, dealing with lender relief from CERCLA liability after foreclosure.

The Section position was submitted to the House of Delegates for action at the mid-Winter, February, 1990 meeting. Through Report No. 104C, the Section position with respect to the liability of fiduciaries under CERCLA was approved as ABA policy.

In addition to these positions with respect to the LaFalce proposal, in November, 1989, the Section also received Blanket Authority for its position with respect to clarification of the "innocent landowner" defense.

V. Issues to be Addressed:

The proposed legislation and suggested EPA rulemaking demonstrate a clear need for clarification of the "security interest" exemption under CERCLA. In order to achieve this clarification, the Section believes that the following principles should govern:

1. There should be reaffirmation of the principle that innocent parties should not be held liable for cleanup of environmental hazards.

2. EPA should exercise its rulemaking authority to provide further clarification (but not greater than required by statute) regarding the actions which lenders are required to take in order to allow them to be afforded the benefits of the "security interest" exemption from CERCLA liability.

3. EPA regulations, by way of definition and guidance, should acknowledge the legislative history behind the "security interest" exemption. In rulemaking, EPA should seek to establish and clarify standards which are capable of consistent and predictable application by borrowers and lenders.

4. EPA regulations and any Congressional legislation should provide clear and predictable guidance with respect to existing loan portfolios, new loans, loan administration, including sufficient time in enforcement and remedies, the secondary mortgage market, and responsibility and liability of entities, court appointed officers such as receivers and trustees, the FDIC, RTC and SBA.

5. To the extent that EPA regulations cannot lawfully address CERCLA liabilities incurred by both public and private response and remedial actions, Congress should provide clear legislation and guidance on this subject.

6. As changes are to be made in the CERCLA law and as rules are proposed, they should be made through an orderly legislative and administrative process with participation of all concerned parties, including hearings with adequate notice and an opportunity for parties to participate in the formulation of the new regulation or law.

While considering such legislation and rulemaking, the Section of Real Property, Probate and Trust Law of the American Bar Association recommends that Congress and EPA should consider questions such as the following:

1. Should a lender be required to undertake "appropriate inquiry", such as an environmental assessment, before making a secured loan and before foreclosing?

2. Should a lender lose its exemption from CERCLA liability if it "causes" or "contributes to" contamination?

3. If a lender is given exclusion from CERCLA liability, should this protection extend to the purchaser from the lender?

4. In defining "due diligence" standards necessary to qualify as an "innocent purchaser", should those standards be set by an EPA rulemaking proceeding, on a case-by-case basis, or through a uniform, industry-wide proceeding, such as the ongoing ASTM proceedings? If "due diligence" standards are to be established by regulatory rulemaking, should the rules be adopted by EPA, or by other agencies such as the Housing Department?

5. If a lender is authorized to foreclose without incurring CERCLA liability, should it be obligated to undertake "reasonable measures" to prevent a release? Should a distinction be drawn between the obligation to prevent continued release or discharge, contrasted to an obligation to clean up previously released contaminants?

6. To the extent that governmental funds are spent to clean up a site which is subject to a lien, is the government entitled to realize a portion of the sales proceeds because of the increase in value caused by the cleanup? If so, how should this be measured?

7. How should the term "lender" be defined?

8. How can any proposed rule or legislation be structured to avoid transfers to a fiduciary merely to circumvent otherwise applicable CERCLA liability?

9. What portion of a fiduciary estate, if any, should be subject to CERCLA liability?

In view of the foregoing, the Section of Real Property, Probate and Trust Law requests the House of Delegates to adopt the above Resolution supporting the clarification of liability of innocent parties, lenders and borrowers under the Comprehensive

Environmental Response, Compensation and Liability Act, together with any required legislation and EPA regulations in order to establish and implement such clarification.

Respectfully submitted,

John J. Lombard, Jr.
Section Chair

February, 1991

AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW
REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED, that the American Bar Association support, in connection with federal legislation relating to the liability of fiduciaries under the Comprehensive Environmental Response Compensation and Liability Act of 1980 ("CERCLA"), such as H.R. 2085 (101st Congress, First Session), exemptions for fiduciaries from liability under CERCLA which encompass all fiduciaries and not just corporate fiduciaries.

BE IT FURTHER RESOLVED, that the American Bar Association, in connection with any legislative reassessment of CERCLA, urge Congress to clarify the bases, if any, for imposition of such liabilities on parties to a fiduciary relationship.

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REPORT

As a result of enactment of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), joint and several liability, unlimited liability, and liability without fault is now imposed on numerous parties. Under Section 107 of CERCLA, there are four classes of responsible parties which can be held liable for the costs of hazardous waste removal:

1. The owner and operator of a facility;

2. Any person who at the time of disposal of any hazardous substances was the owner or operator of the facility where such substances were disposed;

3. Any person who arranged for treatment of disposal of hazardous substances owned by that person; and

4. Any person who accepts or accepted hazardous substances for transport to disposal or treatment facilities.

These parties are generally referred to as owners, operators, generators and transporters. As construed by the Federal Courts, even if the present owner of a site containing hazardous substances is without fault, and had nothing to do with pollution, there is joint and several liability imposed on both that present owner or operator as well as on the former owners or operators of the site.

Although numerous parties have been subjected to liability and threatened liability in the nine years since CERCLA's enactment, concern has recently been expressed with respect to the extent of that liability imposed upon estates, trusts, heirs and trust beneficiaries. In current litigation, private parties as well as government agencies have sought to hold these parties liable for pollution damage that started years or even decades ago, regardless of whether they or their predecessors had anything to do with the pollution. In some cases these parties have received or been threatened with orders to clean up a site. In other instances, EPA and private parties, after undertaking cleanup, have sought reimbursement from the estate, estate administrators, heirs, and in most cases a combination of all of these.

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In one of the earlier CERCLA cases, United States v. Cauffman, (June 11, 1984, C.D. Calif.), in a ruling from the bench, the Federal District Court for the Central District of California held that a trustee could be liable, under CERCLA, for actions taken on behalf of the trust.

On September 27, 1988, the United States District Court for the Eastern District of Missouri, held that statutory trustees, who were officers and directors of a corporation which was dissolved for failure to comply with annual registration requirements, were jointly and severally liable in their capacity as trustees. They were, however, liable only to the extent of the corporate property and effects which came into their possession. United States v. Bliss, Case No. 84-2086C(1), 17 Chemical Waste Litigation Reporter 1061.

In recently settled litigation, the Justice Department sought to impose liability on the beneficiaries of a Florida "land trust" for expenses in connection with cleanup and investigation of pesticide contamination. U. S. v. Tower Chemical Co., No. 85-100-Civ.-Oc-16 (M. D. Fla.), noted in 14 Chemical Waste Litigation Reporter 89 (June, 1987). In the settlement, the land trust beneficiaries agreed to pay a portion of the government's cleanup costs, and to convey the property to the government after cleanup, subject only to mortgages and liens of record before the government filed its lien against the property.

In the case of U. S. v. Burns, on September 12, 1988, the Federal District Judge refused to dismiss a CERCLA cost-recovery claim against a defendant who was a trustee of a trust that owned property that had been used as a hazardous waste site. U. S. v. Burns, Case No. C-88-94-L(D.N.H. September 12, 1988), 16 Chemical Waste Litigation Reporter 1058. Drawing upon analogies to cases involving lessees, the Court concluded that the trustee and beneficiary of the trust that owned the site could be liable as a site "owner" within the meaning of CERCLA, and therefore personal participation in waste disposal activities was not needed to establish liability.

In another case, United States v. Estate of Leonard Forster, (D.C.E. Mich., No. 88-70613, November 25, 1988) [3 Toxics Law Reporter], the Environmental Protection Agency sought to recover cleanup costs from a decedent's estate. The Federal Government argued that the decedent had owned a landfill site while alive, and that the estate currently owned the property. The Government did not allege that either the estate or the decedent operated the landfill, generated hazardous waste deposited on the site, or transported any hazardous waste to the site. The Government initially sued only the estate, but in April, 1989, the District Court, applying equitable principles ordered the United States to join Consolidated Rail Corp. as a party. The estate had presented evidence that contamination of groundwater at the site resulted from industrial waste discharges from railroad tank cars along a nearby railroad right-of-way now owned by Conrail and not from the landfill. In arguing for joinder of the railroad, the estate claimed that the $2,000,000 sought by EPA as cost recovery exceeded the entire value of the estate's liquid assets, and, if awarded, would have left the estate without the financial ability to pursue a contribution action against other parties such as Conrail. Until the Court order, EPA had refused to sue any party other than the estate.

Typical CERCLA-related fiduciary liability questions could include the following:

1. If a fiduciary has ownership liability as the owner of contaminated property, or generator/transporter liability as a source of such contamination, is the trustee personally liable or liable as a corporate entity, or can liability be restricted to the principal of the trust?

2. If EPA attempts to hold an executor liable, is the estate liable if under state law the specific devisee is deemed to take title as of the testator's death?

3. Should a trust beneficiary be held liable, since the beneficiary has only a beneficial ownership in the property and has no control over the trust principal? Can such beneficiary's liability be restricted to its interest in the trust?

The cases noted above, as well as other threatened and pending litigation, do not establish clear criteria to judge the liability of fiduciaries, beneficiaries, or estates. It would appear that even in the routine performance of fiduciary obligations, the fiduciary might be personally liable for what had been seen as solely the liability of that particular trust or estate.

Expressing concern that such circumstances could represent a "virtual windfall for CERCLA claimants in the sense that the assets of the fiduciary are added to the already exposed assets of the owner/operator who passed away or established the trust in the first place", on April 25, 1989, Representative John J. LaFalce introduced a proposed amendment to CERCLA seeking to restrict the CERCLA liability of a fiduciary. A copy of this proposed legislation is attached.

The legislation was designated H.R. 2085 and is now under consideration by appropriate House committees. As proposed, the exclusion from liability would be available to "a corporate

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fiduciary which has legal title to any property for purposes of administering an estate or trust of which such property is a part." [emphasis added]

In proposing the legislation, Representative LaFalce observed that:

> "In many instances bank trust departments are not advised of their appointment under an estate until shortly before the will is offered for probate in the surrogate's court. Thus the Fiduciary may not have any time in which to take those steps which are described for purposes of the "innocent land owner defense" in 42 U.S.C. 9607(b). Although it is possible upon learning of specific problems, the Trustee may decided to renounce its position, such renunciation does nothing for any liability that may have already been incurred under existing law. Also, if the trustee of executor is not replaced, it could leave the trust or estate without any guidance. In effect, the trust or the estate would be set adrift like a ship without a rudder, thereby compounding the problem..." Congressional Record, April 25, 1989, statement of Hon. John J. LaFalce, "Fairness for Lending Institutions".

The LaFalce legislation would "exempt the fiduciary that administers an estate or trust" so that its own assets would not become exposed to liability claims.

The Congressional Record statement gives no indication why the protections proposed under the legislation should be restricted to a "corporate" fiduciary. Even though Representative LaFalce's illustrations indicate the impact of CERCLA-imposed liabilities on bank trust departments, as previously indicated in this Report the fiduciary liability questions created under CERCLA are not restricted to corporate entities. For that reason, there would seem to be little policy reasons to restrict the protection of such legislation to corporate fiduciaries.

Moreover, the breadth of alleged liabilities already asserted in litigation, together with the numerous unanswered questions noted earlier in this Report, suggests that a more extensive re-analysis of the entire CERCLA liability system might be appropriate. While it does not appear that the LaFalce legislation envisions such a broad reassessment, Congressional hearings held by Representative LaFalce's subcommittee, early in August, 1989, documented the prevalence of such unanswered questions.

The LaFalce legislation, in another section, would also permit commercial lending institutions to foreclose on their security interest on property without subjecting such a commercial lending institution to CERCLA liability. Issues raised by such a change, although significant and although also discussed during the August hearings noted above, have not been considered in this Report, nor are they addressed by the Recommendation.

Because of the confusion associated with fiduciary liability under CERCLA, the Council of the Section of Real Property, Probate & Trust Law believes that, in the appropriate circumstances, the entire basis for and extent of liability should be reexamined. At the present time the LaFalce legislation offers an opportunity to clarify one facet of these liabilities. In doing so, the RPP&TL Section urges Congress not to restrict the protection to corporate fiduciaries.

Furthermore, in connection with consideration of the LaFalce legislation, other comparable legislation anticipated for introduction in 1990, or the entire reassessment and reauthorization process for CERCLA, currently scheduled for 1991-92, considering the unanswered questions noted in this Report, the Council for the Real Property, Probate & Trust Law Section believes that Congress should be expressly urged to reexamine and clarify the grounds upon which such liability is imposed on various parties to the traditional fiduciary relationship.

For these reasons, the Council of the Section of Real Property, Probate & Trust Law urges the House of Delegates to adopt the proposed Resolution.

Respectfully submitted,

William B. Dunn
Chairman

February, 1990

STATEMENT OF HARRIS SIMMONS, PRESIDENT, ZIONS BANCORPORATION, SALT LAKE CITY, UT, REPRESENTING THE AMERICAN BANKERS ASSOCIATION

Mr. SIMMONS. Senator Garn, I am Harris H. Simmons, president and CEO of Zions Bancorporation, Salt Lake City. I'm also chairman of the Utah Bankers Association, representing the 38 commercial banks in the State of Utah.

I welcome the opportunity to present the views of the American Bankers Association and the bankers from our State on the problems being encountered with environmental liability, the chilling effect this is having on lending to certain industries, and on our willingness to engage in fiduciary activities.

We're anxious to see legislative solutions implemented which will hold responsible parties accountable for the cleanup of contaminated properties, which clearly outline steps which can be taken by a secured lender to avoid environmental liability, and which provide limitations on the unwitting occurrence of liability by lenders who are not directly responsible for the release of hazardous substances.

I'd like to provide several examples from my own institution and from others in Utah as to the growing nature of this critical problem.

As you alluded to, for many years, my own institution financed an automobile dealership in downtown Salt Lake City. Included in our collateral package was a mortgage on a showroom and repair facility. Three years ago, this dealer experienced financial difficulties which eventually led us to begin foreclosure proceedings on the building.

At the time we began the foreclosure action, we had a party interested in acquiring the building for $2.8 million. We performed a phase 1 and phase 2 site study under EPA guidelines and were informed by the soil engineer that there were minor levels of petroleum compounds which had leeched into the soil.

The engineer noted, and I quote from his letter:

> The measured concentrations of individual organic compounds within water at the water table surface, the zone of contamination, did not exceed primary Federal drinking water standards. These water samples are expected to represent a worst-case—that is, conservative—measurement of ground water contamination. The nearest water supply wells are over 2,000 feet down gradient of the site and completed at depths greater than 120 feet. All these factors indicate that the wells would not be impacted by the shallow release at the site.

We, nevertheless, because of the high standards of RCRA, were required to spend $440,000 digging up pavement and remediating the site. This is in addition to lost interest income of approximately $250,000 during the 2 years it took to identify and complete the cleanup, and a $1,025,000 reduction in the final sale price received on the building relative to the original offer.

I might note that a third of that cost came right out of the Federal Government's pocket because we would have paid tax on the income.

All this is a result of cleaning up soil which was already cleaner than Federal drinking water standards.

In another situation, we have for several years owned a foreclosed property which was the site of a cannery in Murray, Utah.

Subsequent to the foreclosure, it was determined that some of the soil at this site, like other sites in the neighborhood, consists of mine-tailings placed there many years ago. We've not been able to sell the property and as the only remaining deep pocket in the chain of title, may be required to clean up the property which neither we nor our borrower contaminated.

Another bank in Utah had a trust account which held an interest in a promissory note secured by real estate. The note went into default. As a prudent fiduciary, the trust department began foreclosure proceedings, but it determined that the property was polluted. The bank resigned as trustee, alienating a good customer. The customer has not been able to locate a successor trustee willing to take the account.

In another case, a bank in Utah has owned a piece of property in a trust account since the early 1970's, almost 10 years prior to the passage of CERCLA. The property was a salvage yard and used carlot with an underground gasoline tank.

They have recently completed a phase 1 study and are very concerned about the liability they may face as owners in trust of the property.

Several years ago, my bank had a trustee on a parcel of property owned by a fuel transportation company. The customer is now defunct. Prior to foreclosing on the property, we conducted an environmental study and determined that the property was potentially seriously contaminated. We did not complete the foreclosure and abandoned the property for fear of the liability we might incur.

The property remains abandoned, as does another property we held a mortgage on which was the site of a former paint manufacturer.

In sum, the problems are very real. They're having a chilling effect on the willingness of banks to lend to environmentally sensitive companies.

My own bank now has a loan policy which urges loan officers to use extreme caution in lending to a specific list of high-risk industries and there are certain activities we have ceased altogether, such as leasing underground storage tanks.

Our economy can't function without these industries and the businesses which comprise them require access to bank credit.

For the reasons I've cited, banks are very understandably nervous about the huge exposures they may face and lending to these borrowers and the uncertainty about what exists or will exist under the ground which would normally be taken as collateral.

The environmental provisions in your amendment reaffirm the secured lender exemption originally contemplated in the CERCLA legislation. The bill does not let responsible parties off the hook, but serves to provide limited protection for a lender who unwittingly forecloses a contaminated property, even after receiving a report indicating the property is clean.

The bill provides needed legislative guidance on the limited liability of a trustee. ~~This~~ legislation is an excellent first step in limiting the exposure to innocent third parties.

Conceptually, the environmental provisions of this bill are not new. They were included in the original CERCLA legislation. Affirmative action on this bill will provide urgently needed direction to our courts.

There are numerous examples of banks which have been forced to turn down businesses which have come to them for loans to clean up their properties. Excerpts from 25 letters received by the American Bankers Association clearly summarize the problem. These are not anecdotes, but are real-life problems for bankers and borrowers.

I'm also including additional examples with my oral statement which I'd like to be made part of the hearing record.

I'd be happy to answer questions.

Senator GARN. Thank you, Mr. Simmons. And all of your complete statements will be made part of the record.

Mr. Adcox?

[The complete statement of Harris H. Simmons follows:]

STATEMENT

OF

THE AMERICAN BANKERS ASSOCIATION

ON

LENDER LIABILITY UNDER SUPERFUND

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

BY

HARRIS H. SIMMONS

JUNE 12, 1991

Mr. Chairman and members of the Committee, I am Harris H. Simmons, Chairman and President of Zions Bancorporation in Salt Lake City, Utah. I am also Chairman of the Utah Bankers Association. The combined assets of ABA members comprise approximately 95 percent of the total assets of the commercial banking industry. While our members range in size from the smallest to the largest banks, some 85 percent have assets of less than $100 million.

I welcome the opportunity to present ABA's views on the critical issue of environmental lender liability, its effect on the banking industry and possible solutions to this national problem. Mr. Chairman, the ABA and the concerned members of the business community wish to express their appreciation to you for holding this important hearing. We would especially like to thank Senator Jake Garn, the ranking member of this committee whose tireless efforts to solve the unfair liability that can attach to financial institutions under CERCLA. The Senator has been a leader in making environmental lender liability a major issue for the 102nd Congress and the agencies. With respect to the specific issues raised in your May 24 letter we address each of these points during the course of our written testimony.

The ABA is committed to seeking a solution because unless appropriate changes are made to current law, major segments of the business community, particularly small business, will not be able to receive adequate financing when purchasing property which presents environmental risks or when using such property as collateral.[1] Furthermore, this reluctance to lend reduces the capital available to businesses which want to protect or restore the condition of the environment. In addition, the ability of businesses, their owners, and others to use bank fiduciary services has been severely curtailed. Therefore, we urge all interested parties to work toward developing an answer to the problems that create uncertainty in the lending process.

It is critical to understand clearly that this is not just a lender problem; this is a major problem for borrowers, businesses, farmers, and even homeowners. And it is equally important to understand that as each month goes by, the problem grows and grows as lenders learn more about their liabilities and as the potential borrowers come in and ask for loans.

As a matter of fact, in a recent hearing on the status of the Underground Storage Tank Regulatory Program, several witnesses commented on the ongoing problem of getting financing from lenders who are concerned with environmental liability. For example, the Petroleum Marketers Association of America (PMAA), in a 1991 survey, found that one-third of loan applications for underground storage activity were denied by lenders, with lender concerns about environmental liability accounting for the vast majority of denials.[2] At the same hearing, the representative from the National Association of Convenience Stores told the subcommittee that:

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[1] See, Matisik, Environmental Cleanup Liability Makes Banks Leery of Lending, Investor's Daily, July 27, 1989.

> convenience store marketers are having considerable difficulty in obtaining loans for tank replacements, upgrades, leak detection, and corrective actions. ...the hearing record should provide the Subcommittee with ample evidence that a problem with credit exists within the UST community.[3]

Also, a special report issued recently by Moody's Investor Services, Inc., emphasizes that "some industries... may bear such substantial costs for environmental compliance and cleanup that the credit profile of the industry may be altered."[4]

Let's look at a hypothetical that is increasingly becoming standard for the business community. Suppose a dry cleaner owner asks for a $50,000 loan. It might even be for a loan to clean up an environmental problem. The collateral for the loan would almost always be the real property of the dry cleaner, itself. An environmental study -- paid for by the business owner would be required. This could cost from $500 to $2500 -- a very stiff expense on a $50,000 loan. But even with a clean result from the study, would the bank make the loan? Increasingly, the answer is "no!" Why? The study is not foolproof; and therefore the bank is still at risk, first, that its collateral is worthless and, second, that if it has to foreclose, it could face cleanup costs many times the value of the loan. Simply put, why would any lender risk, potentially, hundreds of thousands of dollars of liability over a loan on which it might make a profit, if all goes well, of a thousand dollars or so per year? Can a bank justify such a risk to its shareholders or to its regulators?

Now take this hypothetical and apply it to all types of businesses using chemical products, petroleum, fertilizers, pesticides, etc... It should not be hard to see that this growing problem will have a dramatic impact on whole segments of our economy. One other hypothetical -- suppose the dry cleaner owner (or the gas station, or auto repair shop, or fertilizer distributor) wants to sell his or her business. How is the purchaser going to obtain a loan to buy it when the collateral for the loan would be business property? Thus, the value of thousands of existing small businesses may be severely impacted. Let me quote from a recent letter written by a banker:

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[2] According to the Survey, since "not all marketers have applied for financing... [from lenders], this number obviously represents a much higher proportion of denials for marketers who have actually made an application."

[3] Statement of Louis Sheetz, on behalf of the National Association of Convenience Stores, before the House Energy and Commerce Subcommittee on Transportation and Hazardous Materials (March 20, 1991).

[4] The report went on to estimate that the cost of cleaning up Superfund sites may exceed $500 billion.

> Because of the potential liability, our bank board adopted a policy which prohibits us making loans on any property which presently has [or might in the future present] a toxic waste problem. This would include any chemical, cleaning, petroleum product sales or service or landfill related business. We know and understand these are vital businesses to most communities, but unless banks are relieved of the tremendous potential liability of site cleanup, we will be unable to serve their credit needs.

Some environmental groups have indicated that they believe a change in Superfund will have a negative impact on efforts to clean up the environment. The fact is that clarification of the secured creditor exemption will aid the cleanup of contaminated property. This fact is illustrated by one simple proposition: unless the law is changed, who is going to finance the efforts of businesses and agriculture to undertake environmental cleanup? Carrying it one step further, who is going to finance those companies which specialize in environmental cleanup such as waste management companies? Unless something is done to change the current situation, financing for environmental cleanup is going to be hard to come by. Those businesses which need to borrow to cleanup their properties and those businesses which are in the environmental cleanup business are, by definition, those with the highest risk of environmental problems and, therefore, those that are going to face the most difficulty obtaining financing.

We have heard numerous examples of banks which have been forced to turn down businesses which have come to them for loans to clean up their properties. There are excerpts from letters received by ABA that clearly summarize this problem. These are not anecdotes, but are real-life problems for bankers and borrowers. In testimony before this committee, the Farm Credit Council cited an example of where it had turned down a loan to clean up barrels of waste which had been dumped on a farm. In the trust area one bank recently refused the request of a growing waste management company to serve as a trustee for its ESOP. The bank felt compelled to do so because the stock in the ESOP might place the bank in a position of being as an "owner" at some future date. Thus, a potential source of capital for this waste management company was unavailable. The problem is real and must be addressed.

In sum, the current court interpretations not only create liability for lenders and fiduciaries, but works to the detriment of environmental cleanup by cutting off financing for the cleanup effort itself.

History of the Problem

Overview

Since the passage of the Federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. § 9601, et. seq., known as "Superfund," financial institutions have faced the possibility that their security interest will be impaired and their potential for liability increased if hazardous or toxic materials are discovered on premises which serve as collateral for loans.[5]

CERCLA provides for strict, joint and several liability for the cost of removing and remedying a release or threatened release of hazardous substances and for harm to natural resources caused by such release. 42 U.S.C. § 9607(a).[6] This means that the person bringing an action is not required to prove the defendant acted negligently and that one person can be forced to pay for the entire amount of damages even if other defendants are also found to be responsible. A party will be held liable when it is proven that:

(1) a release or threatened release of a hazardous substance exists;

(2) response costs (e.g. cost of removing the hazardous material) were incurred as a result of the release;

(3) the person falls into one of the four categories of responsible parties outlined in the Act (i.e., current owner and operator of the facility, any former owner or operator of the facility at the time of the disposal of a hazardous substance, a transporter of hazardous materials or a generator of hazardous wastes). (§ 9607(a))

Holding lenders liable for cleanup costs caused by their borrowers' misdeeds is having a tremendous negative effect on commercial lenders and others who use real estate as collateral. Both lenders and borrowers have expressed dissatisfaction with the current provisions of, and decisions under, CERCLA.[7] From the lender's perspective, possible liability for multi-million dollar damages has greatly increased the risk of doing business.

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[5] See, Brown, Superfunds and Superliens: Super Problems for Secured Lenders. BNA's Banking Report, April 14, 1989.

[6] See, e.g.; State of New York v. Shore Reality Corp., 759 F.2d 1032 (2d Cir. 1985).

[7] See, Hearing on The Impact of Superfund Lender Liability on Small Businesses and Their Lenders. Before the House Committee on Small Business, 101st Cong., 2nd Sess. (June 7, 1990).

Even where the lender is not held directly responsible, such liability creates credit risks by reducing the borrower's ability to repay the bank and by impairing the value of the collateral. Prudent lenders are now requiring borrowers to obtain environmental audits (i.e., examination of public records and the property itself to determine whether hazardous substances are present) as a condition for granting a loan. While this is an attempt to limit liability due to the ambiguity of interpretation and the wide-sweeping court cases, these precautionary practices may not protect lenders. As you will see later in this testimony, both H.R. 1450 and S. 651 would go a long way toward clarifying lender practices under Superfund. At best, many borrowers are facing greatly increased loan transaction fees as a result of the lending community's reaction to CERCLA. There are, however, borrowers engaged in certain types of commerce who are finding it difficult to obtain any financing because lenders are reluctant to take the environmental risk.[8]

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[8] In a 1989 Circular from the Federal Home Loan Bank System, the Office of Regulatory Activities outlined eight (8) basic categories of risk to financial institutions from environmentally contaminated property. These include:

1. The risk that the collateral for a real estate loan or property to be acquired may be drastically reduced in value after discovery of the existence of hazardous waste contamination.

2. The risk that the borrower cannot repay the loan if the borrower must also pay for the cost of cleaning up the contaminated property. The cost for cleanup in many cases can be significant and may exceed the institution,s encumbrance on the property.

3. The risk that a mortgage loan may lose priority to a cleanup lien imposed under the laws of those states that require super priority liens for the cost of cleanup. In each of these super lien states, a lien granted to the state securing the cost of cleaning up hazardous waste contamination may have priority over a lender's mortgage.

4. The risk that a lender may be liable to the extent of any credit extended to any debtor who has operated property containing hazardous wastes, has generated such waste, or has transported it in an improper manner. This risk extends to all creditors, not just those who hold as collateral the property containing the hazardous waste.

5. The risk that the bank may become directly liable for the cost of cleaning up a site if it forecloses on a contaminated property or becomes involved in the management of a company that owns or operates a contaminated facility, or is involved in decisions pertaining to the disposal of toxic or hazardous waste.

6. The risk that a lender may not be able to pursue its foreclosure remedies and may have no practical alternative but to give up its loan security, and the right to recover on the loan itself. This could lead to charging off the loan balance.

A poll last year by the ABA's Community Bankers Council[9] (whose banks have assets of $250 million or less) found that 43 percent of the respondents have already stopped making loans altogether to certain types of small businesses most frequently associated with environmental pollution and that another 11 percent plan to do so. This is just the tip of the iceberg. More and more lenders are learning of the dangers they face and are now reacting. I can guarantee that soon whole categories of businesses -- businesses central to our economy -- will basically be cut off from affordable financing, particularly after the ramifications of the Fleet Factors case are fully understood by the industry.

Another letter from the New Jersey Bankers Association (copy attached) shows the results of another survey on environmental liability. The survey found that the replying banks declined to make 249 loans because of environmental liability in 1989-90 totalling $254 million dollars. In addition, a survey by the Indiana Bankers Association shows that 50 of 88 respondents have refused to accept a loan application or a trust agreement because of potential environmental liability.

After the loan is made, CERCLA also presents problems for lenders who are considering whether or not to foreclose on real property. While prudent practice may dictate that a bank foreclose on collateral which secures a defaulted loan, the threat of Superfund liability in some cases requires the lender to walk away from the contaminated property, even in cases where an attempt to clean it up might prove worthwhile.

The difficulties faced by those who hold property in a fiduciary capacity may be even more severe. In many cases the trustee will have no specific knowledge of the nature of the property which is the subject of the trust until the trustee's fiduciary duties become operative. The most common circumstances in which a bank acting as fiduciary may hold real property include: 1) as executor of an estate, sometimes with property flowing into a testamentary trust; 2) in a pension fund which may hold title to a plant or office building; and 3) under a bond indenture in which the bank represents the bondholders and may need to foreclose or exercise other rights over property held as collateral in the event of default. The New Jersey study found that fiduciaries in 1990 declined or withdrew from $16 million in estates for fear of liability. This is clear financial hardship caused by the liability structure.

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7. The risk that the borrower does not maintain collateral or property with an environmental risk potential in an environmentally sound manner.

8. The risk that, aside from the statutory liabilities that can be imposed for toxic waste contamination, there is also potential liability for personal injury or property damage.

[9] ABA is in the process of updating our survey results with a 12,000 member survey which we will make available to the committee upon completion.

As government support for the various environmental liability proposals clearly shows, Superfund liability is not only a private sector concern. Several government agencies have acknowledged the threat they face from the broad scope of CERCLA. The Resolution Trust Corporation (RTC) has acquired tens of thousands of properties from failed savings and loans and is currently attempting to determine which of these might present environmental problems. The Small Business Administration, has stated that it potentially faces CERCLA liability when it guarantees small business loans. Even the residential lender has become wary of lending to prospective home buyers. Properties adjacent to commercial manufacturers or pesticide-contaminated farm land are being turned down for financing.

Due to court interpretation of CERCLA, there is a new philosophy of environmental enforcement that has made lenders increasingly wary of the risks inherent in loan transactions secured by property containing hazardous substances. The risk of decreased value of the collateral for a loan, coupled with potentially enormous liability under CERCLA, has resulted in not only caution on the part of lenders but, as Congressman John LaFalce points out, the unwillingness of lenders "to provide financing to businesses located generally in an area where a possibility of hazardous waste contamination exists even if there is absolutely no showing that the specific property owned by a prospective borrower -- or any adjacent properties are contaminated."[10] As a matter of fact, Mr. Chairman, banks are learning that they cannot afford to lend at all to certain types of small businesses (such as chemical companies) because of environmental liability.

As the Tampa, Florida Tribune so aptly put it in an editorial entitled, "Misplaced Environmental Blame:"

> It seems incredible, but in the United States you can be held liable for something you didn't do, didn't even know about, and that might have happened long before you were born.
>
> Courts are interpreting pollution legislation of the mid-1980's so strictly a bank can be forced to pay to clean up property whose development it financed. Because major cleanups may cost much more than the value of the polluted land, and because innocent lenders are being taken to the cleaners, credit for certain small businesses and farms is becoming very hard to come by.[11]

A recent Newsweek column by Robert Samuelson points out the problem even more dramatically. According to Samuelson, "Small businesses that use or produce toxic substances are finding it tough to get any credit at all -- among them, gas stations, scrap yards, dry cleaners, paint stores and printers. Bankers are terrified of the liability. If such businesses fail, and the lender forecloses, the lender might inherit the cleanup."[12]

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[10] Cong. Rec. E1325 (April 25, 1989).

[11] Tampa Florida Tribune (June 14, 1990).

A Problem for Lenders and Borrowers

Mr. Chairman, you have heard from the banking industry about our increasing reluctance to lend to segments of the small business community. Last year, a community banker from Dana, Indiana (population 800) told the House Small Business Committee:

> With the recent surge of court decisions on environmental liability, our bank has had to carefully consider what types of businesses in Dana could present liability problems. Some of the businesses that are located in Dana that could be affected by possible environmental problems are the community's only auto body shop and convenience store which is also the only place where you can buy gas in Dana. (The other service station closed because of environmental problems and cannot be reopened because it cannot get financing.) Mr. Chairman, there are only two auto repair places in the community and our bank does business with both. There is also only one fuel dealer in the community and we have loaned on the property where the bulk storage is done: financed and secured by that property.[13]

Imagine the damage to the town of Dana if this bank decides it can no longer lend to these businesses; and this bank, the only one in town, was concerned that it might have to cease lending because environmental liability for clean up of any of these properties could literally wipe out the bank's capital. This is an all too common problem.

Many commentators have pointed out that there is a large segment of the business community that is potentially vulnerable to lender reluctance to loan money. Included are gas station owners, auto body shops, and garages. Other firms which use chemicals like printers, dry cleaners, carpet cleaners, pest control firms, or agri-business operations may also be at risk. Many community bankers have begun creating categories of "undesirable borrowers." This reduction in lending eliminates potential business for the banking industry.

It is worth emphasizing the particular problem for small business with respect to lender liability. First, small businesses, in the great majority of cases, must use land and buildings as collateral. This is because they often have little in the way of other assets to use; and in the case of many small businesses, they have little or no operating history on which the lender can rely. If the land and buildings are of questionable value -- or threaten to contain environmental hazards -- the loan is unlikely to be made.

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[12] Newsweek, "Who Cleans Up the Waste?", May 20, 1991, p. 49.

[13] Statement of Lee Schroeder, President, First National Bank, Dana, Indiana, Before the House Small Business Committee (June 7, 1990).

In addition, it should be noted that there is a high failure rate in small businesses. This makes this type of lending particularly risky. Thus, there is even a greater need to rely on collateral -- usually land and buildings. Furthermore, there is often a need for the lender to work with the borrower, who may not be financially sophisticated and/or who may run into financial problems, particularly in the early stages of a start-up business. However, as will be discussed more fully later, the Fleet Factors decision has put a tremendous chilling effect on the ability of lenders to work with borrowers if there is any possibility of environmental problems.

One further problem is that, where small business is involved, the lender -- particularly a bank -- will almost always be seen as the deep pocket. Any type of large liability will probably wipe out the small business, and therefore the tendency will often be to go after the lender for cleanup costs. In addition, the ability of a small business borrower to indemnify a lender for environmental liability is minor, at best, since the small business will probably be bankrupt itself as a result of the liability. The lender loses twice, first by losing the loan amount, and second, by having the environmental cleanup costs imposed on it. Thus, there is a reliance by the government for lenders to "police the activities" on properties subject to Superfund and RCRA. This reliance is premised upon the lack of guidance for lenders. As one commentator put it: "Because CERCLA was virtually silent on the meaning of the secured creditor exemption, lenders have little guidance on what activities might subject them to liability."[14]

A Problem for Fiduciaries

The trust area is another aspect of the banking business which exposes the industry to potential environmental liability.[15] ABA strongly believes that banks should not be burdened with the liability for cleanup of hazardous substances on land merely because they hold title in a fiduciary capacity. Consider the following:

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[14] Comment, Lender Liability Under CERCLA Deserves More Than a Fleeting Glance, 1991 U. Ark. Little Rock L.J. 209, 211.

[15] For example, a letter to ABA pointed out:

> We were the trustee of a funded grantor trust of a certain individual who appreciated and felt a need for our investment and record keeping services. He happened to own, with his wife, and operate a local landfill. He became embroiled in a dispute with the state Environmental Protection Agency, which claimed that the landfill was improperly operated. Suit was filed against the owners and several other defendants in an action seeking more than $4 million in damages.

A bank may be executor (and perhaps testamentary trustee) of a decedent's estate. Included among the assets is a piece of real estate that, years before, may have been the site of a landfill or a mine, long since shut down. It is later discovered that chemical pollutants remain on the property.

The bank did not cause the pollution. Perhaps even the decedent had no involvement -- the polluter could have been a prior owner. Nevertheless, the bank, as current owner, could be liable for the total cleanup even beyond the assets of the estate or trust.

Liability can result in a number of other ways. For example, in older cities, prior uses of property such as dry cleaning, jewelry making, or even uses unknown to current residents, could have led to ground pollution. Should a bank unwittingly take such property into trust or an estate, liability for cleanup costs could result.

We were aware of the existence of a will executed by this gentleman with standard pour-over provisions which would have transferred title to the landfill to his inter vivos trust.

As you might imagine, this situation caused us to examine our position carefully, and we determined that it would be critical to the shareholders of our bank that we prevent title to the property from passing to the bank as trustee. We approached the grantor, explaining the situation and the implications of the law and its effect on the liability of the parties. We expressed our desire to resign as trustee.

This placed him and his family in an awkward position. Anyone accepting the role as successor trustee was inviting, at a minimum, substantial involvement in litigation, and at worst, exposure of his or her entire net worth to liability.

The matter was resolved by having this gentleman name his spouse as trustee. Approximately two weeks after having made the change, he died. His wife is now immersed in the litigation. As co-owner of the property, she was exposed anyway. But she now bears the entire burden of litigation as well as the other duties befalling her as trustee. She has not participated in the business, has no financial background, and, in essence, has been thrust into the very type of situation that her husband originally hoped to spare her by naming an independent corporate trustee.

One need only change the circumstances of this case slightly to find an almost impossible situation. If both husband and wife were killed and wanted to leave their assets in trust of the benefit of their heirs, query who would be willing to serve as trustee.

Bank fiduciaries may become involved with contaminated real property in any number of ways. In an executorship, the bank's involvement may be limited, requiring only maintenance of the property until a suitable buyer can be found. A bank may also be a testamentary trustee, which will require active management of the property for the benefit of the beneficiaries -- for example, the decedent's minor children. A bank may also assume legal title when the trust holds obligations secured by real property and foreclosure on the obligation is required. Finally, in the event of a default on a bond issue, a bank as an indentured trustee might be required to take legal title or be required to manage certain real property for the benefit of bondholders. Not to do so may render a bank liable to the bondholders.

Unfortunately, CERCLA provides little protection for bank fiduciaries trying to avoid liability. The so-called "third-party" or "innocent landowner" defense requires that the contamination be due solely to actions of a third party with whom the bank has no direct or indirect contractual relationship. 42 U.S.C. § 9607(b)(3). Because a contractual relationship would include trust agreements, a bank would not come within the meaning of statutory defense, unless it qualified as an "innocent landowner."

That defense applies if the real property was acquired after the disposal of the hazardous substance and, 1) at the time of acquisition, the defendant did not know and had no reason to know any hazardous substance was disposed on or at the property or 2) the defendant acquired the property through inheritance or bequest. 42 U.S.C. § 9601(35) (A). Even where a bank fiduciary meets the stringent requirements for the innocent landowner defense, which would be difficult unless the trustee investigates all land it receives in a trust, it may still be subject to liability under CERCLA. Because bank fiduciaries may be required to maintain the property for the benefit of the beneficiaries, they risk being held liable as operators rather than owners of the contaminated property.

Nor does abandonment represent a viable option. If a trustee chooses to abandon the claim of a trust, the beneficiaries may allege a breach of fiduciary duties.

This same dilemma holds true for indentured trustees that normally have no liability for the underlying business. If there is an event of default, however, and the trustee, pursuant to its obligation under the trust indenture, acquires title to, or has to actively manage the business or the contaminated property, the indentured trustee may well be deemed an owner or operator for purposes of CERCLA. Again, abandonment of the property is not an option as the indentured trustee will have certain obligations to the bondholders under the terms of the indenture.

As a result of CERCLA's strict liability provisions and in an effort to protect themselves from such liability, bank fiduciaries have become reluctant to accept appointments for certain trusts designated as high risk. Prior to accepting an appointment, a bank will follow procedures similar to those for commercial lending activities. For example, a bank will physically inspect the property to be held in trust as well as all potential acquisitions that may occur as a result of secured obligations held by the trust. Inspections will cover not only the property itself but also facilities in the general vicinity of the property. Research of the history of the property both its former owners and tenants and former uses -- will be required. Environmental audits ranging in cost from $1,500 to $20,000 may also be necessary.

A bank fiduciary will also inquire whether any business to be held in trust is incorporated. If it is not incorporated and is, in fact, a proprietorship or a partnership the fiduciary might immediately become liable upon acceptance of the account. It would be very difficult to successfully argue that the fiduciary is not the owner or operator if the interest it took upon acceptance of the account was that of proprietor or general partner. On the other hand, the fiduciary may not be able to avoid liability even if the business is incorporated since courts will pierce the corporate veil in order to recover environmental cleanup costs. See United States v. Northeastern Pharmaceutical and Chemical Co., 810 F.2d 726 (8th Cir. 1986), cert. denied, 108 S. Ct. 107 (1987).

Mr. Chairman, the net effect of these pre-acquisition screening procedures is to increase costs and delay the appointment of a trustee and any distributions to the beneficiaries. Moreover, unless a fiduciary is satisfied that it has adequately assessed the risks associated with the real property to be held in trust, no professional fiduciary will accept appointment. Declining such appointment is becoming especially common where the property previously housed a gas station or other potentially hazardous business. In this situation, the trust or estate is left without the benefit of a professional fiduciary's guidance.

Courts Have Misinterpreted Superfund

The Association believes it is critical that we restore the original intent of CERCLA. The Association further believes that it was the intent of the Congress to exclude innocent lenders from liability, but that court interpretations have undercut that intent.

Most of the litigation involving commercial lenders under CERCLA focuses on two aspects of the lender's relationship with the borrower. Such suits attempt to show that the lender is an owner or operator of the property where the cleanup costs have been incurred. The typical fact pattern involves a lender which finances a business borrower and takes a security interest in real property. (A "business borrower" can include an agricultural borrower. While CERCLA contains an exception to liability for damages resulting from the application of a federally registered pesticide product, 42 U.S.C. § 9607(i), there are other situations in the agricultural lending context which can result in CERCLA liability.)

CERCLA defines "owner or operator" in § 9601(20)(A). Although this definition is somewhat circular, it specifically states that the term does not include a person "who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." (Emphasis supplied.) This definition, in effect, exempts a mortgagee from CERCLA because the mortgagee would fall outside the four categories of "responsible parties."

Cases such as U.S. v. Maryland Bank & Trust Company, 632 F. Supp. 573 (D. Md. 1986); U.S. v. Mirabile, No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 Envtl. L. Rep. 20,994; and Guidice v. BFG Electroplating and Manufacturing Co. Inc., 732 F. Supp. 556 (W.D. Pa. 1989) consider the scope of the exemption for holders of a security interest in real property. Both Maryland Bank and Trust and Guidice construe the language of § 9601(20)(A) narrowly and conclude that a mortgagee loses its exemption from CERCLA liability when it forecloses on the property. These courts base their decisions on the fact that the lender no longer "holds" (present tense) indicia of ownership to protect its security interest but, upon foreclosure, actually becomes the owner of the property. The Mirabile court did not take such a strict interpretive approach. It ruled that the bank's foreclosure and other activities in the subsequent four months prior to selling the property were undertaken merely to protect the bank's security interest in the property and did not cause the bank to lose its statutory exemption under CERCLA. Mirabile, 15 Envtl. L. Rep. at 20,996.

Mirable and Guidice also consider another important aspect of the exclusion from the definition of owner or operator -- the degree of control the lender may exercise over the borrower's business and still remain outside of CERCLA. This is a key issue for lenders because liability under the Act can occur even though there has been no foreclosure. (In fact, liability can arise even though the lender has not taken a mortgage on the real property.) It is not unusual for a commercial lender, especially one whose borrower is having financial difficulties, to become involved in some aspects of the borrower's business in order to preserve the lender's financial stake in repayment of the loan. As the cases point out, the primary focus in this area is on the degree of the lender's participation in the management of the borrower.

At one time lenders and their counsel were fairly confident that they could distinguish between permissible activities and those which would result in liability under the Act. A major court decision, however, has modified the analysis of "owner" liability found in these earlier cases and greatly exacerbated the problem. United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. May 23, 1990), cert. denied, 59 U.S.L.W. 3478 (U.S. January 14, 1991)(No. 90-504).

As the Dallas Times Herald stated in an editorial:

> On May 23, a federal appellate court... ruled a bank, which had foreclosed on the property of a bankrupt firm and auctioned it off several months later, was liable for cleaning up the property though it had had no role in managing the company. The court held that secured creditors should be liable if they could effect hazardous waste disposal decisions,' whether or not they actually exercise a role in management or know anything about hazardous waste disposal.

> If these decisions stand, banks that routinely lend operating or expansion funds to small businesses, such as local gas stations, or large industries will have to close their lending windows to avoid liability for problems they had no hand in.[16]

Unfortunately, since the Supreme Court has refused to review the Fleet decision, there is now a new and broader standard of environmental liability than previously existed -- a standard that is sending shock waves through the lending community. This case holds that, despite the explicit exclusion in the Superfund law for lenders who hold a security interest in property, it may be inferred from the nature of their financial relationship with their borrowers that such lenders are owners of property and thus liable for cleanup.

Fleet Factors focused on the capacity of a lender to affect financial management, as contrasted with operational management. Prior to Fleet Factors, the courts had found secured creditors liable for Superfund costs only where the creditor actually owned or operated the contaminated facility. Creditors became owners only after foreclosure on the property. What has confounded the business community was Judge Kravitch's sweeping language in Fleet Factors construing the term owner:

[A] secured creditor may incur liability [as an "owner"], without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste. It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable -- although such conduct will certainly lead to a loss of the protection of the statutory exemption. Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose. (Emphasis supplied.)

Mr. Chairman, the impact of Fleet Factors on the lending community is painfully obvious. The 11th Circuit is sending the message that prudent lenders should not continue their time-honored efforts of being active in assisting a borrower during a troubled period because if they do they are liable for any pollution cleanup costs. Lenders will now be safer taking a complete hands-off approach to their loans and ignoring their security interest in the facility or real estate that serves as collateral. This decision opens lenders to environmental liability for participating in financial aspects of the borrower's business that were not considered a basis for liability under Mirabile, Guidice, and the lower court decision in Fleet Factors. (See, 724 F. Supp. 955 (S.D. Ga. 1988).)

Rather than setting forth a bright-line test to guide lenders, the panel creates an amorphous standard which makes it even more difficult to determine what a lender can safely do. It may not be too farfetched to say that anything more than lending money and requesting that the borrower pay it back with interest would trigger liability under the panel's test. Of course, this means that lenders will be even more reluctant to lend at all to certain types of businesses. And, once again, those hardest hit will be small businesses.

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[16] Dallas Times Herald, June 9, 1990 A-20.

The decision in Fleet Factors holds that a lender with the "capacity to influence" a borrower's hazardous waste management decisions becomes liable for cleanup costs and other damages under CERCLA. The catastrophic nature of such damages calls into question the continued value of what are now deemed to be prudent lending practices. The overly-broad nature of the panel's decision was unnecessary to resolve the issues presented to the court and the holding in Fleet Factors threatens to cause great harm to both lenders and borrowers.[17]

Lender Defenses

In addition to the exemption in the definition of owner or operator discussed above, CERCLA establishes several defenses to liability. These are found in § 9607(b) and relieve a person from liability under the Act where the damages from a release or threatened release of a hazardous substance are caused solely by an act of God, an act of war, or "an act or omission of a third party...." (Emphasis supplied.) From the perspective of the commercial lender the so-called third party defense is the most important because in the typical case where the lender acquires real property by foreclosure, it will have been the borrower or some other third party who has actually caused the release of the hazardous substance.

There are several qualifications to the third party defense. The "third party" must be someone other than "an employee or agent of the defendant" or someone whose act or omission occurs in connection with a contractual relationship. § 9607(b)(3). Since enactment of the Superfund Amendments and Reauthorization Act of 1986, P.L. 99-499, it is clear that the term "contractual relationship" includes "land contracts, deeds or other instruments transferring title or possession..." § 9601 (35)(A). Despite this language, a defendant who acquires contaminated real property may still be entitled to assert the third party defense if it, he or she can show that the property was acquired after the hazardous substance was placed there and that "[a]t the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release... was disposed of on, in, or at the facility." § 9601(35)(A)(i).

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[17] It is of little comfort that other courts and the EPA have rejected a broad reading of Fleet. The 11th circuit, in In re Bergsoe Metal Corp., 910 F. 2d 668 (1990), ruled that a lender must exercise actual management authority before it can be held liable. The Environmental Protection Agency also appears to recognize the problem with the Fleet decision. In a draft rule, received in January, the EPA pointed out:

> "Participation in the management of a facility sufficient to void the exemption means actual participation in the management or operational affairs by the holder of the security interest, and does not include the mere unexercised capacity or ability to influence facility operations."

The limited scope of these defenses is readily apparent. In particular, the third party/innocent landowner defense provides little in the way of true protection. The litigation expenses necessary to establish the defense when coupled with the cost of environmental audits (which may be necessary to establish that the lender "had no reason to know") make this defense an extremely expensive and uncertain way of avoiding liability. In addition, there are no guidelines establishing what is an appropriate level of inquiry; and even if there were, nothing prevents the EPA or a third party from pursuing a lender to recover cleanup expenses if hazardous substances are discovered. It is very important to note that because the bank will almost always be seen as the deep pocket, there will be a strong incentive to include the bank if there is even a remote possibility of liability. In any event, this defense is not available in the situation found in Fleet Factors where the lender is charged with being the owner of contaminated property because it managed the business which released the pollution.

Nature of Liability

Liability under CERCLA is far-reaching. Frequently, a lender that forecloses and buys a mortgaged property or takes back a deed in lieu of foreclosure may find itself liable to the federal government for cleanup costs that may well exceed the value of the real estate and improvements. Banks may also be directly liable under Superfund for cleanup costs that can easily exceed the loan amount.

Another major problem with CERCLA is that it imposes liability retroactively. Thus, a defendant can be held liable under CERCLA for the cleanup from activities that occurred 60 years ago, even though CERCLA was not enacted until December 11, 1980. Experts have opined that "there is no reason to believe that the parties who now engage in the generation, treatment or disposal of hazardous materials or the cleanup of hazardous waste sites, will not be held liable for damages caused by these activities years in the future."[18] Therefore, there is no assurance of protection for lenders who have competently handled their responsibilities under CERCLA today.

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[18] Angelo and Eggert, "Environmental Considerations in Business Transactions." Paper presented to the American Bar Association, Section of Business Law, Banking Law Committee, October, 1988.

CERCLA has also been interpreted to impose joint and several liability on everyone involved with a contaminated site, including a lender. This wide-sweeping liability scheme makes it clear that CERCLA and RCRA will, by their very nature, result in lenders being more involved in preventing liability. The problem is, however, that there is no protection regardless of activity. When the harm cannot be divided and apportioned appropriately, all liability can be imposed upon any one defendant, or upon all of them. This aspect of CERCLA makes it attractive for the Environmental Protection Agency (EPA) and third parties to focus its enforcement efforts on only those parties involved with a site that are financially well-off, whether they are directly responsible for the damage or not. Financial institutions are often perceived as being the logical choice for footing the cleanup costs because of the "deep pocket" syndrome. As a result, financially viable entities, or those that are generally believed to be viable (including banks), might end up paying for cleanup costs that others have caused, years ago.

Courts have also ruled that CERCLA imposes personal liability. A corporate officer's or shareholder's personal assets can be subject to CERCLA liability. The corporate form may sometimes provide no protection against liability for certain individuals because a court may choose to rule that the shareholder or officer is an "operator" under CERCLA, and thus, directly and personally liable.

Other Laws Imposing Liability

While this testimony focuses primarily on the lender problems associated with court interpretations of CERCLA, there are several other risks to lenders beyond Superfund.

The federal Superfund statute is not the only source of potential environmental liability for the borrower and lender. Some states, including Massachusetts, New Hampshire and New Jersey, have also enacted "Super Lien" provisions which permit the state to clean up properties where toxic wastes are found and to collect the costs from the owner, operator, or some other responsible party. If the cleanup costs are not paid, they become a lien against the property that has a super priority over all other liens, security interests, and mortgages. A lender in one of these states may find its lien subordinated to the extent of the cleanup costs, which frequently greatly exceed the value of the property and the bank's loan on it. These statutes dramatically affect a secured lender's recourse to ensure payment of a loan. Thus, the banking industry is faced with the expense of becoming expert in federal and state environmental law and auditing of property. Some states have enacted "mini-Superfund" laws prohibiting the discharge of hazardous substances and authorizing state environmental agencies to clean up discharges and to recover the costs from responsible parties. These state statutes often raise many of the same problems for lenders as CERCLA.[19]

The Federal Resource Conservation and Recovery Act (RCRA) 42 U.S.C. § 6901 et. seq., requires the EPA to establish a comprehensive, "cradle-to-grave" hazardous waste management program. Title 42 U.S.C. § 6991 regulates the majority of underground storage tanks. The regulations interpreting RCRA require owners of underground storage tanks (USTs) to register information about the tanks with state regulators and the regulations include a comprehensive regulatory scheme for financial responsibility and external release detection systems. Most older USTs have a life of 15 to 20 years. Some sources estimate that as many as 50 percent of current USTs leak. UST cleanups generally involve groundwater contamination and can be more costly than a cleanup involving soil contamination. Leaking underground storage tanks are a major risk for lenders who extend credit without verifying the condition of USTs and the borrower's compliance with environmental laws. While lenders have focused primarily on their liability under CERCLA, the appendix shows that many lenders believe that any solution must also address their potential liability of innocent lenders under RCRA.

This is also why lenders have worked closely with several groups that are pushing for change in RCRA. There is a need to amend RCRA so that lenders are given direction on the scope of their potential liability. (See appendix.)

Economic Impact

The effect of the confusing liability on borrowers has been well documented. As the Chairman of the House Small Business Committee, John LaFalce, stated:

"The real loser here is the small business community... well-run, credit worthy businesses that cannot obtain the financing they need to survive because their lenders are afraid of Superfund liability."[20]

What must also be emphasized is the plethora of industries that are affected by lender reluctance to provide financing. Many sites do not fit the scenario of rusting barrels oozing with noxious substances. The following is a partial list of potential problem businesses:

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[19] As a matter of fact, there is an ongoing effort in the state legislatures to clarify the issue of environmental lender liability.

[20] Opening Statement of Rep. John J. LaFalce, Chairman, Committee on Small Business, June 7, 1990.

- Residential areas and developments may contain asbestos fill (a hazardous substance) or be located over former landfills;
- gas stations and other businesses with underground storage tanks, such as auto dealerships and fleet operators;
- auto repair shops;
- dry cleaners;
- tool and die shops;
- wood preserving facilities;
- scrap yards;
- railroad facilities;
- utilities;
- bottling and canning facilities;
- metal fabricating facilities;
- semiconductor plants;
- chemical manufacturers and distributors;
- fertilizer or pesticide producers and distributors.

The American Bankers Association also wants this committee to note the exposure the agricultural community faces in the environmental area. A recent ABA publication, "Agricultural Lenders Guide to Environmental Liability," states in the introduction:

> In recent years, we have seen the problems of environmental contamination transfer from the owner of a property to the lender who financed the property. While the charge-offs due to this transfer are still not commonplace in agricultural banks, they are increasing at an alarming rate. In addition, rural residents and consumers are focusing more and more attention on

carryover and residues from the use of chemicals in agricultural enterprises.[21]

The businesses affected in the agricultural community are extensive. Businesses such as feedlot operations, grain elevators, co-ops, fertilizer and chemical dealers and suppliers, poultry operations, meat packing and rendering facilities, cattle ranches, hog production facilities and traditional crop operations may generate, use or dispose of hazardous materials or generate other wastes which pose a risk to the environment.

Since lenders often make loans secured by residential properties, any of those properties located near landfills or other environmentally hazardous areas will also be a cause of great concern to the financial industry.

Response to Criticism of Efforts to Limit Lenders' Environmental Liability

Mr. Chairman, I would like at this point to address some of the concerns that have been raised about the various legislative proposals designed to deal with the growing problem of environmental liability. Quite frankly, the ABA still believes that these concerns are either invalid or vastly overstated. Therefore, in a moment, I will deal with them one at a time.

It is imperative, however, to recognize the widespread support for both the LaFalce and Garn bills. Rep. LaFalce's bill, H.R. 1450 would reverse the Fleet decision and allow lenders to assist troubled borrowers. Sen. Garn's bill, S. 651, anticipates regulations on due diligence , but also reverses Fleet. ABA supports both bills.

Once again, the industry wants to acknowledge the leadership of Sen. Garn during the past several years on advancing the issue of lender liability clarification. Since the introduction of the ABA-supported Garn bill, the EPA has released its interpretation of lender liability under CERCLA. We would like to work with the committee and Sen. Garn's staff to assess whether provisions in the rule could be incorporated into S. 651.

The first concern that is raised relates to the potential for an increased cost to Superfund. As I understand it, the concern is that if the lending institutions do not pay for the cleanup, a larger burden will be imposed on the Superfund itself. The first point that should be raised with respect to this concern is a question of fairness. If, in fact, the lender has nothing to do with causing the pollution, it does not seem fair that the government should impose a burden on the lender merely because it is a convenient "deep pocket."

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[21] "Agricultural Lenders Guide to Environmental Liability," 1990, American Bankers Association.

Fortunately, this does not appear to have been Congress' intent.[22] It is only appropriate that there should first be some culpability on the part of the lender. Otherwise, the same argument could be made about any source of funding -- to cite an extreme example, the first three people to walk down the street past the relevant waste site -- if they do not pay for it, the government will have to pay more.

In addition, it must be emphasized that in the long run the government is not likely to obtain a significant amount of funds from the lending community. Any funds that are obtained will be obtained somewhat in the fashion of a lottery. Lenders are quickly learning that in order to protect themselves, they must not foreclose on property that may have an environmental problem. Since Fleet Factors, lenders have, unfortunately, started making adjustments in the way they deal with their borrowers before foreclosure -- for example, not seeking to provide financial advice to troubled borrowers which may have pollution problems. As a result, the only lenders who will be caught are those who make mistakes in handling distressed borrowers or those who become involved with property where the pollution was hidden. Most significantly, lenders will have no choice but to stop lending to those types of businesses which present environmental risks.

Nevertheless, there is no doubt that innocent lenders will, under current legal interpretations, be forced to provide some additional funding for pollution cleanup that will, therefore, spare the Superfund some expense. The trade-off for this use of the innocent lenders deep pockets, however, is tremendous economic dislocation. Again, whole categories of businesses, agriculture, and, potentially, consumers will find it extremely expensive if not impossible to obtain financing. It is clear that the cost of the economic havoc which will result greatly outweighs any benefit from additional funding that may be obtained from lenders pockets.

Furthermore, as stated in the introduction, if the current legal interpretations remain unchanged, existing environmental problems will continue unabated because financing for cleaning up these sites will increasingly become unavailable.

The second concern that critics of this legislation have expressed is that lenders will no longer have the incentive to perform environmental audits if the current liability scheme is clarified. As stated before, bankers undertake these precautionary practices, but have no guarantee of protection.

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[22] See, e.g., Tom, Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA, 98 Yale L. J. 925 at 928 (1989) which points out that:

> a policy of imposing liability on banks because they are "deep pockets" is not supported by the statute, which explicitly exempts secured creditors from liability under certain conditions.

Superfund and RCRA are silent as to the specific role to be played by the lending community in protecting and cleaning up the environment. Lenders who fit within the scope of the secured creditor exemption are under no obligation to perform cleanups nor is there a requirement that lenders conduct audits or otherwise supervise their borrowers activities in order to qualify for the exemption.

In fact, commentators have suggested that the current narrow construction of the secured creditor exemption (which had been actively sought by EPA until very recently) is actually counter-productive if the goal is to encourage lenders to monitor their borrowers' hazardous waste activities.[23]

However, proposals offered by Sen. Garn and Congressman LaFalce that will require that audits be performed, under certain circumstances, to ensure protection. Regardless of these proposals, lenders will have a tremendous incentive to continue the practice of conducting environmental audits on properties on which they are lending. The reason for this is quite simple: if the property is polluted, even where the lender is not liable for cleanup, the lender still stands to lose the entire value of its loan. This alone provides tremendous motivation to assess the condition of the collateral. Not only is the security value of a given property impaired by pollution, but the borrower is given an incentive to walk away from the loan, knowing that the property is impaired or even worthless. Furthermore, since the borrower will be liable for cleanup costs, the ability of that borrower to repay the loan from other sources will be impaired or wiped out.

Those who oppose efforts to add certainty to the Superfund laws fail to acknowledge that lenders will always be liable for any hazardous substances that are released by action of the lender. There is no attempt to totally eliminate Superfund liability of lenders.

The final concern, and frankly the most difficult to comprehend, is the attack on the proposed changes to CERCLA and RCRA by trade groups such as the Chemical Manufacturers Association (CMA). According to testimony given last year by CMA, their members are opposed to any change in the liability structure of Superfund because CMA members "are subject to heavy liabilities under Superfund...[and there is] no clear or compelling reason to give preferential treatment to lending institutions...". Without repeating the entire history of Superfund, it should suffice to point out that lenders were given a "secured creditor exemption" under the law while the members of CMA were not. This simple fact, and the different treatment lenders have been granted, is never acknowledged by CMA.

There is another fact that should be emphasized when discussing this "opposition" to any CERCLA amendments that address the secured creditor exemption. There are several trade groups represented in a broad business coalition supporting the need to restore the secured creditor exemption that engage in the same business as members of CMA (list attached). However, these groups are different from CMA members in one large way--they need financing from lenders. The lack of available financing is not a concern for large companies. The effect of Superfund on small business is a major reason why there exists a broad coalition of supporters.

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[23] 98 Yale L.J. 925, 931 (1989).

I can assure the Committee that lenders will continue to perform environmental audits and, rightly or wrongly, serve as environmental "detectives." In fact, numerous programs are underway throughout the lending industry to develop new and innovative responses to the need for environmental audits.

Hopefully, we can get beyond the excessive rhetoric of the scope of the problem and address this national concern.

Impact on Federal Agencies

It is important that the Committee also consider the effect that the current interpretation of CERCLA will have on the federal government. The Small Business Administration has already said that:

> SBA is currently faced with potential cleanup liability once it buys in collateral at a foreclosure sale upon default of an SBA borrower. When SBA honors a guaranty the collateral for the loan is assigned by the lender to SBA and the Agency or the lender, acting at the request of the Agency, proceeds to liquidate the collateral. When SBA liquidates a direct loan it proceeds on its own with respect to its collateral. Often it is deemed appropriate by SBA to buy in the collateral at foreclosure, in order to hold the property in a custodial manner for future resale, in order to minimize the government's loss on the default.
>
> Under Federal environmental statutes, it is possible that such buy-ins make SBA the owner of the subject property and, as a result, potentially liable for cleanup costs. Even though SBA is a lender of last resort, thereby incurring more risks than private lenders, we do attempt to minimize the government's losses upon a borrower's default. If the Agency is found to be a party responsible for cleanup costs, that only adds to Federal liabilities.
>
> SBA now faces the possibility of spending unknown amounts of money for site cleanups simply because of foreclosure actions taken to minimize the

government's loss following the default of a small business borrower.[24]

The present law is also having a negative impact on the ability of the RTC to sell assets. This impact is only going to increase as concern about lender liability grows and grows, as it certainly will. There are two ways that the current situation will cost the RTC money -- and we suspect the cost may eventually be in the billions of dollars. First, potential purchasers of RTC property are going to pay less, since they must be concerned about their potential liability on RTC property. But the impact of the current interpretations goes beyond that. In order for a purchaser to buy property from the RTC, he or she is probably going to need a loan. It is going to be very difficult, if not impossible, in many cases where pollution may be present for the potential purchasers to obtain financing. This difficulty will arise because lenders will be reluctant to lend on property which may have pollution problems. This difficulty and/or added expense will be reflected in lower prices, fewer bids, and, in some cases, no bids on RTC properties.

The second way in which the current situation will have a negative impact on RTC is that those purchasing S&Ls will be much more likely to return assets (mostly loans) to the RTC. It is widely understood that the RTC is better off the more it can move assets to the purchasers of a given S&L. However, the purchaser of an S&L - say, for example, a bank holding company - is going to be very reluctant to keep any assets, even if they may appear to be performing loans, unless that purchaser can be assured that there are no potential environmental liability problems with respect to such assets. To have any assurance, the purchaser would need to do extensive environmental audits, and of course, even such audits are not foolproof. The result is that such purchasers of S&Ls are much more likely to give back assets to the RTC, thus greatly increasing the expense to the RTC and, ultimately, to the taxpayers.

EPA Proposed Rule on Lender Liability Under CERCLA

The ABA is pleased at the recent release of the EPA's long-awaited proposed rule on environmental liability. We were happy to learn that the Treasury Department and the Vice President's Council on Competitiveness played a major role in developing the rule for public comment. While the banking industry is already preparing its comments on the rule, the statement by Deputy Treasury Secretary Robson is encouraging. The Deputy Secretary said, "the rule will provide greater certainty to bankers and other lenders, both private and governmental, that they will not be subject to Superfund liability or to the effects of costly litigation when they work with troubled borrowers, take necessary steps to protect the value of collateral, provide credit to borrowers with a known environmental clean-up requirement, and foreclose on defaulted loans." The policy shift will go a long way toward protecting lenders from Superfund ambiguity. There may remain some problems if the rule were to be the only action taken on environmental liability. First, the rule does not address the trust activities that may cause liability. Secondly, the extent to which the rule can bind third parties is not clear. Finally, the rule cannot and does not cover RCRA. These problems would seem to make a legislative solution the only appropriate remedy.

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[24] Statement of Sally B. Narey, General Counsel, U.S. Small Business Administration, Before the Committee on Small Business, U.S. Senate, March 21, 1990.

Conclusion

Mr. Chairman, there has been a groundswell of support for restoring the Congressional intent for lender responsibility under Superfund. Borrower groups have joined the effort, and already 223 Members of the House have cosponsored legislation offered by Rep. LaFalce (H.R. 1450) and 22 have co-sponsored Sen. Garn's bill (S. 651). The incredible decision in Fleet Factors has dramatically raised the stakes for the U.S. economy. A list of the broad coalition of concerned businesses as well as their statement of support for change is attached for your information.

CERCLA has become a trap for the lending community with widespread negative economic implications. It is not only lenders which face threats to their economic health. A wide range of businesses including service stations, dry cleaners, high-tech manufacturers, industrial concerns and agriculture are paying -- and will continue to pay -- the cost of imposing environmental liability on lenders. These "costs" are not simply the added fees necessary to conduct environmental audits of real estate or higher interest rates caused by the greater risk (or lower value of real estate as collateral) of certain types of loans, but also include the inability of borrowers to get any financing at all. If no relief is forthcoming, lenders will simply be forced to stop extending credit to those borrowers which create exposure to environmental liability either because of the type of business in which they are involved or because their balance sheet offers the lender little protection.

By removing the lender and fiduciary from liability (except in cases where they have caused or contributed to the release or threatened release of a hazardous substance), the liability can be placed on the party or parties actually responsible for the damage. More importantly, the tremendous negative impact on businesses, agriculture and, in some cases, individual consumers will be abated. As the Solicitor General noted in his brief to the Supreme Court in Fleet Factors, Congress is the appropriate forum to address the issues of environmental lender liability and we urge the Congress to move as expeditiously as possible to enact legislation along the lines of the Garn and LaFalce proposals.

I would be happy to answer any questions.

APPENDIX

A Sampling of Lender and Borrower Problems Under CERCLA*

Montana:

One bank wrote off a loan rather than repossess a gas station, thereby leaving the problem to local government to handle. Another case also involved a bank who could not dispose of property where there was a gas station. Another bank's capital would be impaired if it was forced to pay clean up costs simply because it foreclosed on a pole treating plant. The end result is banks are not making loans to entrepreneurs who wish to purchase or build gas stations, dry cleaning establishments, and other similar businesses.

Delaware:

Almost ten years ago, a bank was named as a co-defendant in CERCLA litigation brought by a municipality in connection with the bank's foreclosure on a chemical plant. After foreclosing on the property, we entered into a contract with a construction company to remove chemical waste found at the site. The construction company entered into a sub-contract with a disposal company to remove some of the chemical waste. The City alleged that the disposal company bribed the City's employees in order to gain access and to dump chemical waste at the City's landfill. The City's analysis of the waste found at the site determined that the waste from the plant constituted 8.37 percent of the total waste. However, the City sued each and every named defendant for the full amount of all damages alleging that the defendants were jointly and severally liable for the total amount. The amount in issue was $34,200,000.

While ultimately the matter was settled within insurance policy limits, the matter was of grave concern because we were a "deep pocket" defendant in the matter. We firmly believe we acted prudently in connection with the foreclosure, yet we were constrained to settle the litigation rather than risk a finding of joint and several liability in the courts.

Midwest:

There is a major credit crunch for many businesses in the district. We recently denied, due to the bank's potential liability, a credit request for a local fuel transporter who was purchasing a terminal. In other cases where we have approved the credit, we required a very expensive environmental audit. We are also reviewing our acceptance of fiduciary responsibilities and may require such audits prior to our acceptance of an account in our trust department.

*** These are excerpts from letters sent to the Congress by lenders who have been hurt by the broad reach of CERCLA.**

West:

One banker said we would probably release a real estate mortgage if the loan were paid down to a few thousand dollars, rather than risk the liability of possible waste clean up.

Still another banker had just been handed the keys to an oilfield service company pipe yard a couple days earlier. He knows there are two fuel tanks in the yard, but hadn't had time to attempt to evaluate toxic waste problems yet.

Missouri:

If legislation is not passed limited the lenders liability, we will be left with little alternative but to refuse lending to customers who may have a potential for hazardous waste cleanup. The most prevalent of these at the present time are gasoline service stations, convenience stores and any businesses with underground storage tanks.

Utah:

Many of the banks in Utah already have enormous liability under this law. We have foreclosed auto dealerships, trucking companies, and other properties and have come under liability in the hundreds of thousands of dollars for environmental cleanup. Naturally, we had no idea that the properties were contaminated when loans were made on them.

Virginia:

By way of an example, one of our banks recently had to walk away from its collateral securing a loan and take a loss rather than risk limitless liability in the cleaning up of toxic waste on the property which could have compounded the loss. There was no knowledge of the toxic waste when the loan was made and the bank certainly did not cause it. Because of experiences such as this, small businesses in which there might be an environmental risk are finding it more difficult and/or more expensive to obtain loans to operate.

Illinois:

Corporate fiduciaries across the state are responsible for the great majority of the assets held in trusts and estates in Illinois. We have become greatly concerned about liability to our banks under the stringent environmental laws that may go beyond the assets of the trust and hold the bank itself liable, even though the bank may be a blameless titleholder. We are frequently unable to accept a fiduciary appointment because of a real estate holding in the account that may have environmental problems. The cost of some cleanups can be so great that they may exhaust the trust estate and would greatly impair a bank's capital if the bank were held liable.

Kansas:

I am sure you have heard many examples of lending institutions declining loans strictly out of fear of liability. Downtown Wichita is a prime example with a four square mile area possibly contaminated, and no one is willing to lend money in this area because of the potential risk of liability just by being associated with the project.

Kansas:

As you are aware from our previous conversations, this matter is a severe problem for all of the lenders here in Wichita in as much as, our downtown area is faced with a clean up of underground water pollution. The status now is that it is not possible to obtain a loan on downtown real estate and indeed many lenders including ourselves, are choosing to accept losses rather than foreclose on properties which are affected. We as a community, need legislation to enable us to revitalize our downtown area and without it, the tax base of our community is going to be dramatically eroded as a result of the inability to finance improvements.

Virginia:

With the open-ended environmental threat presently over our heads, the bank has found it almost impossible to make loans secured by gasoline stations. We have been forced to abandon real estate collateral that was found to be polluted rather than to foreclose and satisfy the debt. We chose to take a loss rather than foreclose on our collateral and become the "deep pocket" owner in the chain of ownership of the property.

Texas:

I can sincerely and honestly say that threat of environmental liability is giving lenders pause as to whether or not it is worth lending if there's any risk of environmental liability. Our margins are just too thin in the mortgage lending business to take on a risk such as this. Also in order to protect ourselves, we are requiring Phase I and Phase II environmental studies which must be paid for by the borrower, which in the case of small to medium size loans are prohibitive in proportion to the actual loan. That of course causes a great deal of resentment by our customer. Our solution is to just stay away from that kind of transaction which is bad for the economy and bad for our customer.

Maryland:

We had an incident a few years ago where we found it easier for both the bank and a small business borrower for the borrower to pledge his home rather than to incur all the expense and aggravation of undertaking an environmental audit on the business property of the small businessman. There was no reason to believe that the ground was polluted, but we could not take a chance since the Superfund liability for a lender is open-ended

Our bank, and no other financial institution can afford these additional costs. We are forced to decline loan applicants where there is the slightest doubt about the possible contaminants unless the customer agrees to pay the costs of having a survey done. This often puts the applicant in a position where he simply cannot afford the cost. The bank, on the other hand, can't afford not to insist upon the survey so our local citizenry suffer, taxes fall off, support of schools dwindle and the downward spiral seems unending.

Michigan:

There was a one year delay in negotiations on a merger because of the cleanup of a five acre scrap year foreclosed upon by the acquired entity. The intended cost was estimated to be $5.7 million. Close to two million was paid for the cleanup and the merger finally went through.

A small bank in central Michigan wrote off the balance of a $100,000 loan in a small, neat brick building on one acre of property. Besides the loss, the bank has had to pay over $400,000 in cleanup costs from its own capital.

A bank with a problem mortgage on a scrap yard recovered as much as possible from secondary collateral but walked away from their primary collateral and took a loss rather than take title to the scrap yard.

A 600 acre farm in trust has it leased to a horsebreeder. Unfortunately a relative of the breeder was a wastehauler. Two kids found 3700 barrels of waste in the woods on the property. At least $400,000 was spent in the cleanup. Fortunately the trust was large enough to cover the cost and no personal assets were attacked.

Another major bank successfully ran a closely-held manufacturing facility for the benefit of the widow and children. The deceased grantor had disposed of his waste in the back of the facility. The state DNA held that because the bank was involved in management, they could be liable.

My own bank sold a small cottage held in an estate. Three months after the sale, the local fire marshal had to evacuate 1/2 mile of the shore around the cottage. It seems the decedent had buried a 55 gallon drum for gasoline storage. The barrel rusted, the gas (approximately 10 gallons) drained into the groundwater, the gas moved in the ground water, and the fumes collected in the well pit over which the decedent had built a family room. That accounted for the explosive nature of the problem. The cottage is now listed on the state cleanup list.

A bank on the western side of the state was notified that they may be party to a cleanup lawsuit because of an estate they had closed 4 years before! The decedent collected old car batteries and sold them to a supplier who disposed of them in a landfill that is now leaking.

Texas:

Our bank is and has been involved in lawsuits involving environmental problems:

1. Environmental Clean-up - A foreclosure on a customer, we discovered that the property was allegedly contaminated. A major environmental company had to clean up the property. The company billed in excess of $300,000.00 for the project.

2. State Agency - X company unknowingly foreclosed on property which was allegedly contaminated. The state agency knew of the problem well in advance of the foreclosure but failed to file a notice of the problem in the real property records as required. In order to protect its interests, X company has to file a lawsuit against the state agency, conduct test on the property and may ultimately be forced to bear the expense of repetition.

3. Sales of ORE - There are several instances where X company foreclosed on real estate and sold it with no knowledge of any environmental problem. The buyer has alleged environmental problems and threatened to sue X company. In one instance the buyer alleges he lost a lucrative sale as a result of the alleged contamination. The buyer them made demand for the difference between the purchase price and the alleged potential sale price and has alleged that the sale constituted a violation of the Deceptive Trade Practices Act.

Oklahoma:

The current unstable situation is a burden to both lenders and borrowers. Let me give you one example. Our customer, which as a result of a reorganization is the owner of a tract of property, applied for a $125,000 loan. The loan was to be secured by that tract as well as a piece of agricultural land. Consistent with our policy, we required a full Phase I audit on the property. The loan applicant, of course, bore and is bearing the expense directly. The audit, which cost approximately $2,500, disclosed potential problems. The cost to take a further look at the property, a Phase II audit, would be between $12,000 and $40,000. While the possibility of any serious problems is only about 10%, it would be extremely imprudent for us to make the loan and thereby risk our capital as the party potentially liable for cleanup (the site is above a shallow aquifer). It is economically impossible to earn enough from a $125,000 loan to justify the risk of potentially cleaning up an aquifer. Our customer is, not surprisingly, shaken. It is beginning the Phase II work. Hopefully a test well will show no subsurface contamination and its property clean enough to use as security. Our customer still has borne a tremendous expense for a relatively small credit.

STATEMENT OF DAVID ADCOX, PRESIDENT, HIGHLAND CORP., HOHENWALD, TN, REPRESENTING THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Mr. Adcox. Mr. Chairman, my name is David Adcox and I am president of the Highland Corp. of Hohenwald, TN.

Highland is a motor fuel distribution company serving approximately 20 convenience stores and other commercial customers in a 7-county area of rural middle Tennessee. Highland employs more than 40 individuals.

Because of the subject of this hearing, I would also like to mention that for the past 16 years, I've been on the board of directors of a local bank, and from 1985 to 1988, I was the bank's president and chief executive officer.

I'm testifying today on behalf of the Petroleum Marketers Association of America. PMAA commends the committee for holding this hearing today. We very much appreciate the opportunity to provide our views on environmental liability, an issue that is of crucial importance to our membership.

PMAA is a federation of State and regional trade associations representing members in all of the continental United States. PMAA member associations represent over 10,000 independent petroleum marketers. These marketers account for nearly 50 percent of the gasoline and 75 percent of the home heating oil sold in the United States. Eighty-nine percent of PMAA's membership is classified as small business under size categories established by the Small Business Administration.

As a general observation, Mr. Chairman, independent petroleum marketers are in dire need of capital, primarily to comply with the Government regulations which over the past several years have been promulgated to ensure cleaner air and water.

This demand for capital can best be seen in the area of petroleum underground storage tanks, or UST replacements and upgrades. Many of our members are finding it difficult to obtain the financing necessary to upgrade and replace their tanks. Without upgraded, new tanks, insurance companies are reluctant to offer our members pollution liability insurance at anything approaching a reasonable price.

The inability to obtain insurance means that many of our members are finding it impossible to come into compliance with the Environmental Protection Agency's underground storage tank financial responsibility requirements. It ends up being a vicious circle, Mr. Chairman.

Your letter of invitation asks for our views on S. 651. The focus of this legislation is directed to Federal banking institutions and PMAA has no objections to any of S. 651's provisions.

However, in order for our members' problems to be resolved, we would prefer that the Resource Conservation and Recovery Act, or RCRA, be explicitly amended in a way similar to section 2 of H.R. 1450, a bill introduced on March 15 by Congressman John J. LaFalce, and which now has over 220 cosponsors.

In response to questions 2 and 3 of your invitation letter, our members are experiencing extreme difficulty in obtaining financing from lending institutions, mainly in connection with trying to finance the upgrade and replacement of UST. And without question, the major obstacle in obtaining that kind of financing definitely results from lenders' concerns with the environmental risk associated with our industry.

In order to capitalize the expenditures necessary to achieve compliance with the UST regulations in a timely manner, many petroleum marketers are now turning to their bankers, who have in the past proved a reliable source of financing.

Typically, marketers seek to offer the real estate on which their UST's are located; that is, at retail gasoline outlets, as collateral for the loan. Many marketers now report that their lending institutions are increasingly reluctant to provide financing for UST-related property and activities.

Our 1991 survey showed that 42 percent of respondents have applied for financing for an UST-related activity. Of those who have applied, fully one-third of these loan applications have been denied by the lender, with lender concerns about environmental liability accounting for the vast majority of denials.

Because of this increasing reluctance by many lending institutions to assist in the financing of UST upgrades and replacements is, according to the American Bankers Association, due to fears that their liability under the statutes governing the UST program are likely to be construed as broadly as under superfund.

In response to question 4 of your invitation, our members rarely obtain credit from their suppliers for purposes of making investments necessary for compliance with environmental laws.

Historically, suppliers have been concerned with extending credit for many of the same reasons as banks, fearing that they could be held liable for any contamination that might be found. There also seems to be a fear that such loans could increase the likelihood that they would be held jointly and severally liable under RCRA for cleanup.

You also asked us to address in questions 5 and 6 the extent to which the major integrated oil companies expanding their share of the retail distribution market, how it has affected our ability to obtain credit and how it has affected our business.

In response to this, the lender liability problem is hitting independent petroleum marketers at the worst possible time. Many are going out of business, either because of their inability to obtain the capital to do the environmental upgrades, or because of the aggressive and unfair marketing practices of the major oil company competitors.

As a result of both the capital availability problem and the unfair competitive practices of refiners, the relative market share of independent petroleum marketers has declined substantially in the last 5 years.

According to the DOE, major oil company sales through wholesalers dropped 14 percent between 1986 and 1989, and at the same time, sales by major oil companies through stations they own, operate and control increased by 14 percent.

The financial situation of marketers has worsened in the last year, primarily because the capital has become more difficult to obtain and because the major oil companies immediately following the Persian Gulf war engaged in a series of practices that have further eroded the relative market share of independent marketers.

For the most part, these practices have included charging wholesalers a higher price for gasoline than the same refiner sells the gasoline to the motoring public. The activities of the major oil companies in expanding their market share has also hurt marketers in their ability to obtain credit. This has occurred because bankers viewing loan applications for markets see not only an environmental risk in the applicant, but quite possibly a business with eroding sales.

In response to what we view as inequities in the marketplace, PMAA, along with other marketing groups, is developing Federal legislation that we believe would level the playing field in terms of the independence in the majors. We expect that legislation to be introduced before the end of the month.

Mr. Chairman, PMAA offers three recommendations in response to the lender liability problem, especially in connection with petroleum underground storage tanks.

First, PMAA urges the enactment of S. 651, providing it includes provisions specifically amending RCRA. These provisions would go a long way in resolving the lender liability problem in connection with RCRA and underground storage tanks.

Second, we urge EPA to extend the UST financial responsibility deadline to the end of 1992. This action would allow the 102d Congress to act on the lender liability problem prior to adjournment.

And third, PMAA will be urging support for soon-to-be-introduced anticompetitive practices legislation.

Thank you.

[The complete statement of David Adcox follows:]

PMAA PETROLEUM
MARKETERS
ASSOCIATION OF
AMERICA

Statement of

Mr. David Adcox

On Behalf Of

The Petroleum Marketers Association of America

Before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

On

Lender Liability and S. 651

Washington, D.C.

June 12, 1991

MEMBERS OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

The Petroleum Marketers Association of America (PMAA) represents the independent petroleum marketers who are members of these state and regional trade associations:

Alabama Oilmen's Association
Arizona Petroleum Marketers Association
Arkansas Oil Marketers Association, Inc.
California Independent Oil Marketers Association
Colorado Petroleum Marketers Association
Independent Connecticut Petroleum Association
Florida Petroleum Marketers Association
Georgia Oilmen's Association
Idaho Oil Marketers Association
Illinois Petroleum Marketers Association
Indiana Oil Marketers Association, Inc.
Petroleum Marketers of Iowa
Kansas Oil Marketers Association
Kentucky Petroleum Marketers Association
Louisiana Oil Marketers Association
Maine Oil Dealers Association
Michigan Petroleum Association
Mid-Atlantic Petroleum Distributors Association
Mississippi Petroleum Marketers Association
Missouri Petroleum Marketers Association
Montana Petroleum Marketers Association
Nebraska Petroleum Marketers Association, Inc.
Nevada Petroleum Marketers Association
Independent Oilmen's Association of New England
New England Fuel Institute
Fuel Merchants Association of New Jersey
New Mexico Petroleum Marketers Association
Empire State Petroleum Association
North Carolina Petroleum Marketers Association
Northwest Petroleum Association
Ohio Petroleum Marketers Association
Oklahoma Oil Marketers Association
Oregon Petroleum Marketers Association
Pennsylvania Petroleum Association, Inc.
Petroleum Marketers Association of Wisconsin
South Carolina Oil Jobbers Association
South Dakota Petroleum Marketers Association
Tennessee Oil Marketers Association
Texas Oil Marketers Association
Virginia Petroleum Jobbers Association
Washington Oil Marketers Association
Western Petroleum Marketers Association
West Virginia Petroleum Marketers Association
Wyoming Petroleum Marketers Association

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Testimony
By
The Petroleum Marketers Association of America
On
Lender Liability and S. 651
Before
The Committee on Banking, Housing and Urban Development
United States Senate
Washington, DC
June 12, 1991

Good morning Mr. Chairman and members of the committee. My name is David Adcox, and I am President of the Highland Corporation of Hohenwald, Tennessee. Highland is a motor fuel distribution company serving approximately 20 convenience stores in a seven-county area of rural middle Tennessee. Highland employs more than forty individuals. Because of the subject of this hearing, I would also like to mention that for the past sixteen years, I have been on the Board of Directors of a local bank, First Citizens. During 1985 - 1988, I was the bank's President and Chief Executive Officer.

I am testifying today on behalf of the Petroleum Marketers Association of America (PMAA). PMAA commends the committee for holding this hearing today. We very much appreciate the opportunity to provide our views on environmental liability, an issue that is of crucial importance to our membership.

PMAA is a federation of state and regional trade associations representing members in all of the continental United States. PMAA member associations represent over 10,000 independent petroleum marketers, including gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline resellers/retailers, and thousands of retail fuel oil dealers, as well as independent marketers serving the industry by storing and supplying petroleum products.

These marketers account for nearly 50 percent of the gasoline and 75 percent of the home heating oil sold in the United States. These marketers sell their products under either their own private brand or trademark of their supplier. PMAA marketer members also market motor fuels through ownership of nearly 19,000 convenience stores. Eighty-nine percent of PMAA's membership is classified as small business under size categories established by the Small Business Administration.

BACKGROUND

As a general observation, Mr. Chairman, independent petroleum marketers are in dire need of capital, primarily to comply with government regulations which over the past several years have been promulgated to ensure cleaner air and water. This demand for capital can best be seen in the area of petroleum underground storage tank (UST) replacements and upgrades. Many of our members are finding it difficult to obtain the financing necessary to upgrade and replace their tanks. Without upgraded/new tanks, insurance companies are reluctant to offer our members pollutionliability insurance at anything approaching a reasonable price. The inability to obtain insurance means that many of our members are finding it impossible to come into compliance with the Environmental Protection Agency's UST financial responsibility requirements. It ends up being a vicious circle, Mr. Chairman. Our members want to do the right thing, but the environmental liability problem has created a morass that works against what we believe was the goal of the Congress when it enacted various environmental laws -- cleaning up our environment. Having offered these general observations, let me respond specifically to the six questions you raised in your letter of invitation. At the conclusion of our comments on question four, we will comment on EPA's lender liability rule released on June 5.

COMMENTS ON S. 651

Your letter of invitation asked for our views on S. 651, a bill introduced by Senator Garn on March 13 and referred to this committee. The focus of the legislation is directed to federal banking institutions, and PMAA has no objections to any of S. 651's provisions. However in order for our members' problems to be resolved, it appears that the Resource Conservation and Recovery Act (RCRA) would need to be amended in a way similar to Section 2 of H.R. 1450, a bill introduced on March 14 by Representative John J. LaFalce and which now has over 220 cosponsors. While USTs are regulated under RCRA and not Superfund, many banks fear that liability under the statutes governing the UST program are likely to be construed as broadly as under Superfund. A comparative review of the provisions relating to lender liability in both Superfund and Subtitle I of RCRA and the LUST trust fund would tend to underscore, rather than allay, these fears.

PMAA MEMBERS' DIFFICULTIES IN OBTAINING LOANS FOR UST REPLACEMENT/UPGRADE PURPOSES DUE TO LENDERS' CONCERNS WITH ENVIRONMENTAL RISKS

In response to questions two and three of your invitation letter, our members are experiencing extreme difficulty in obtaining financing from lending institutions, mainly in connection with trying to finance the upgrade and replacement of USTs. And, without question, the major obstacle in obtaining that kind of financing definitely results from lenders' concerns with the environmental risks associated with our industry.

Mr. Chairman, before describing the difficulties our members are facing in connection with obtaining financing for UST upgrades and replacements, let me first describe EPA's UST regulations.

The UST Regulations

In 1988, EPA issued regulations to require owners and operators of petroleum underground storage tanks to begin the costly process of upgrading systems and installing leak detection at their UST sites (40 CFR 280.20 et. seq.). EPA estimated the total costs of the requirements to be approximately $63 billion over 30 years (53 Fed. Reg. 37190). Of the approximately 2 million regulated USTs in existence, many are owned by small businesses whose companies do not have the financial assets necessary to comply with the regulations, according to EPA (53 Fed. Reg. 37096).

In recognition of the immense economic burden these technical standards would impose, the regulations allow the leak detection of tanks and piping to be phased-in over a 5 year period. The upgrading process, including corrosion protection, is phased-in over a 10 year period. Financial responsibility requirements, also issued in 1988, establish a much shorter phase-in schedule based upon the number of tanks owned (40 CFR 280.90 et.seq.). Under EPA's current phase-in schedule, revised in 1990, all categories of the regulated community must be in full compliance by October 26, 1991, although EPA's announcement, in March of 1991, offers the possibility that category IV owners (1-12 tanks) may receive as much as a one-year extension, to October 26, 1992.

Efforts to obtain insurance to comply with the financial responsibility deadlines have resulted in a drastic acceleration of the technical standards, as insurance companies have insisted on clean sites and tight tanks prior to writing coverage. Tightness tests of tanks and piping cost approximately $600 per tank. Soil sampling of tanks and piping costs approximately $1750 per tank, assuming four samples at the tank, and three along the lines. Replacement costs for a single tank can range up to $50,000, depending on tank type.

The average marketer represented by PMAA owns approximately 4 gasoline retail outlets. Each outlet has approximately 3 tanks. The average marketer's annual net income is approximately $66,000, according to a 1990 financial profile of independent petroleum marketers conducted by PMAA. According to PMAA's 1991 Survey of Gasoline Marketer Underground Storage Tank Activity (1991 Survey) (see Attachment I) marketer expenditures on tank replacements and upgrades amounted to approximately $133,000 per company in 1990, and are expected to be in the $121,000 range in 1991. Leak detection expenditures amounted to 28,000 per company in 1990, and were expected to average approximately $29,000 in 1991.

Banks Are Increasingly Rejecting Marketer Loan Applications

In order to capitalize the expenditures necessary to achieve compliance in a timely manner, many petroleum marketers are now turning to their bankers, who have in the past proved a reliable source of financing. Typically, marketers seek to offer the real estate on which their USTs are located (i.e. at retail gasoline outlets) as collateral for the loan. Yet, although they have generally established themselves as good credit risks, according to Small Business Administration statistics[1], many marketers now report that their lending institutions are increasingly reluctant to provide financing for UST related property and activities. PMAA began receiving anecdotal reports as early as the Spring of 1989; as a result, the Association wrote to EPA to request a clarification of RCRA lender liability on July 13, 1989 (see Attachment II).

In addition to studying a number of other UST-related issues, the 1991 Survey examined marketer financing needs and activity for a period of two years, between 1989 and 1990. PMAA has no financing data for the years prior to 1989. According to the 1991 Survey, 42 percent of respondents have applied for financing for an UST-related activity[2]. **Of those who have applied, fully one-third of these loan applications have been denied by the lender, with lender concerns about environmental liability accounting for the vast majority of denials.** Marketers are also facing more stringent terms for loans in general. Respondents to PMAA's 1991 survey report that over the past two years, their financial institutions have imposed new loan terms, including environmental site assessments (44.5%), personal guarantee for environmental matters (32.5%), and site or tank cleanup prior to loan (23%). Some marketers have reported that their banks are requiring a "state of the art" environmental audit that includes, among other things, tests for metal contaminants and a full-spectrum hazardous waste evaluation. A complete environmental audit can cost up to $10,000 or more per site.

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[1] According to 1989 Small Business Administration data, of 633 guaranteed loans since 1979 to gasoline wholesalers (SIC Code 5171) the Agency has experienced a failure rate of only 11.8%. This is a highly favorable payback rate, according to the SBA.

An often cited obstacle to financing is the existence, or fear of existence, of contamination on the premises, for which the lender could be held responsible. Historical delivery practices, in which small amounts of product have been released to the ground surface when the delivery truck's hose is disconnected from the fill pipe, have resulted in a certain amount of contamination at virtually all UST sites. Because of the small volumes involved, this sort of contamination does not generally pose a threat to surrounding areas or require costly cleanup. EPA regulations, which require spill and overfill equipment, will prevent this sort of contamination from occurring in the future. Even contamination from leaking USTs, while potentially of more serious concern, does not, contrary to prevailing public opinion, generally cost millions of dollars to clean up. Rather, according to the 1991 survey, average cleanup costs per-site amount to $53,750. Of that figure, assessment costs average $11,404 and remediation costs $42,346.

USTs Were Not Intended to be Subject to Superfund, but Rather RCRA

It should be noted that UST leaks were not intended to be subject to Superfund's response authorities due to that statute's comprehensive petroleum exclusion (42 U.S.C. 9601(14) & (33)). Instead, they are regulated under Subtitle I of RCRA; and response authority for certain UST releases is provided pursuant to the $500 million LUST Trust Fund established by the Congress in 1986. Nevertheless, because of generalized fears about Superfund liability, many lending institutions have withdrawn from the business of offering financing to the petroleum marketing industry.

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[2] Many respondents to the 1991 Survey indicated that they have not even applied for financing specifically because their banks have made clear that they will not lend for any UST-related activity.

The cause of this increasing reluctance by many lending institutions to assist in the financing of UST upgrades and replacements is, according to the American Bankers Association, due to fears that their liability under the statutes governing the UST program are likely to be construed as broadly as under Superfund. An environmental guide published by the American Bankers Association articulates these fears as follows:

> For many years, industrial and other commercial entities have stored heating oil, gasoline, solvents and other chemicals in tanks located beneath the ground. In recent years it has become apparent that many of these tanks have leaked. Congress responded to public concern about this problem by requiring EPA to regulate underground storage tanks ... Additionally, Congress provided $500 million to EPA to pay for a government cleanup of past leaks from such tanks. EPA is empowered to recover the costs of these cleanups from the parties legally responsible for the leaks. The present owner or operator may be liable for this cleanup even if it was unaware that the tanks existed. **Government agencies and courts are likely to construe this part of RCRA as broadly as Superfund and may extend liability to lenders, particularly if there is no other party available to pay the costs.** (Emphasis added)[3]

Whether liability under RCRA will be construed as broadly as Superfund is a question that has yet to be decided by the courts. However, a comparative review of the provisions relating to lender liability in both Superfund and Subtitle I of the Resource Conservation and Recovery Act (RCRA) and the LUST Trust Fund would tend to underscore, rather than allay, these fears, from the lender's perspective.

Superfund and RCRA: A Comparison

o Standard of Liability

Again, UST leaks were not intended to be subject to Superfund's response authorities because of the petroleum exclusion. However, the standard of liability under both Superfund and the LUST Trust Fund is the same. Under both statutes, **the term "liability" is defined identically as "the standard of liability which obtains under section 311 of the Federal Water Pollution Control Act."** (See 42 U.S.C. 6991b (h)(6)(A) (LUST Trust Fund) and 42 U.S.C. 9601(32) (Superfund)). Looking first to Superfund, which was hastily passed in 1980, the bill that actually became law had virtually no legislative history to accompany it. Although there was no explicit strict liability provision in Superfund, the courts have consistently held that, with regard to Superfund, this standard results in the imposition of liability that is strict, joint and several. This has resulted in cases that have imposed liability for cleanup costs not only on generators, transporters, and past and present hazardous waste site owners and operators, but also upon those who have had a more tenuous relation to the production and disposal of hazardous waste.

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[3] Managing Environmental Risk: A Practical Guide for Bankers, American Bankers Association (1989).

Legislative history to accompany the LUST Trust Fund sheds no further light on the section 311 standard of liability than Superfund, and thus there is little doubt that the courts will decide that liability under the LUST Trust Fund is also strict, joint and several. Although there are significant differences between Superfund and the LUST Trust Fund with respect to, for example, affirmative defenses available, whether the courts will widen the scope of liability in LUST Trust Fund cases in a fashion similar to Superfund is not a matter that can be clearly determined by reference to the statute. Again, it remains a matter for the courts to decide.

o Secured Creditor Exemption

Both Superfund and the LUST Trust Fund provide what is known as "security interest exemptions" (Superfund section 101(20)(A) and LUST Trust Fund section 6991b(h)(9)). The language of these two statutory provisions are similar, indicating that the Congress used the exemption language in Superfund as a model for that found in the LUST Trust Fund. In Superfund, the exemption provides that a person is not an owner or operator, and thus not subject to liability if **"without participation in the management of a vessel or facility, [he] holds indicia of ownership primarily to protect his security interest in the vessel or facility."** Similarly, under the LUST Trust Fund, a person is not an owner if **"without participating in the management of an underground storage tank and otherwise not engaged in petroleum production, refining and marketing, [he] holds indicia of ownership primarily to protect the owner's security interest in the tank."**

In effect, both statutory security interest exemptions exempt from liability those creditors who merely hold indicia of ownership to protect their security interests but do not participate in management of a facility or tank. The LUST Trust Fund would also require a finding that a lender is not otherwise engaged in production, marketing or refining prior to making a determination whether the exemption applies, again, it is for the courts to decide, based on the facts of each case, when a lender is protecting its security interest and when it has crossed the line into managing the facility or tank, and engaging in petroleum related activities. In any event, the fact that the language of the "security interest" exemption in the LUST Trust Fund "tracks" so closely the language in Superfund may be invoked by future courts as reason to give precedential value to the line of cases construing lender liability under Superfund in actions seeking cost recovery against lenders under the UST program.

The question of when the lender has crossed the line into management of a facility was recently addressed for the first time by a federal appeals court in U.S. v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. May 23, 1990)(cert. denied, January, 1991). The ruling handed down in this case established a greatly expanded theory of secured lender liability under Superfund. It held that the lender "crossed the line" if its involvement in management "is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." While the court held that some level of actual participation by a security holder is required to abrogate the exemption, the court's opinion did not discuss what level of financial participation would be sufficient to support the inference that a security holder's involvement could influence operational decisions. Until Fleet Factors, lending institutions essentially could avoid liability by not foreclosing on contaminated collateral and not becoming involved in day-to-day operating decisions. Dicta in the case implies that the mere financing of inventories may be enough to establish liability. A subsequent decision by the Ninth Circuit Court of Appeals confirmed that the mere capacity or unexercised right to control facility operations is insufficient to void the exemption, and held that "there must be some actual management of the facility before a secured creditor will fall outside the exemption." In re Bergsoe Metal Corp., 910 F. 2d 668, 672 (9th Cir. 1990). EPA's rule announced on June 5 applies to Superfund and not to RCRA.

To reduce the uncertainties surrounding the secured creditor exemption, the EPA released a proposed rulemaking on June 5 to specify the range of permissible actions that may be undertaken by holders of a security interest within the bounds of Superfund's security interest exemption. However, this rulemaking only applies to Superfund, and does not specifically clarify the security exemption under RCRA. Nevertheless, the proposed rule may serve to "increase the comfort level" of lenders with respect to all "environmentally risky" borrowers. Because of the remaining uncertainty, PMAA urges Congress to enact legislation similar to H.R. 1450. Such action would clarify this issue in a way which would be unmistakably clear to lending institutions.

o Credit From Suppliers

In response to question four, our members rarely obtain credit from their suppliers for purposes of making investments necessary for compliance with environmental laws. Historically, suppliers have been concerned with extending credit for many of the same reasons as banks, fearing that they could be held liable for any contamination which might be found. There also seems to be a fear that such loans could increase the likelihood that they would be held jointly and severally liable under RCRA for any cleanup.

MAJOR INTEGRATED OIL COMPANIES ARE EXPANDING THEIR RETAIL MARKET SHARE AT THE EXPENSE OF INDEPENDENT MARKETERS, THUS EXACERBATING THE FINANCIAL DIFFICULTIES OF INDEPENDENTS

In response to question five, the lender liability problem is hitting independent petroleum marketers at the worst possible time. Many are going out of business either because of their inability to obtain the capital to do the environmental upgrades or because of the aggressive and unfair marketing practices of the major oil company competitors. Those that are not going out of business have experience a significant decline in the profitability of their business.

As a result of both the capital availability problem and the unfair competitive practices of refiners, the relative marketshare of independent petroleum marketers has declined substantially in the last five years. According to the Department of Energy (DOE), major oil company sales through wholesalers dropped 14% between 1986 and 1989. At the same time, sales by the major oil companies through stations they own, operate and control increased by 14%.

The financial situation of marketers has worsened in the last year primarily because the capital has become more difficult to obtain and because the major oil companies, immediately following the Persian Gulf War, engaged in a series of practices that have further eroded the relative marketshare of independent marketers.

For the most part, these practices have included charging wholesalers a higher price for gasoline than the same refiner sales the gasoline to the motoring public. To illustrate the financial plight of our members, a recent PMAA survey shows that the average net income dropped by over 40 percent between 1989 and 1990, but per marketer per gallon averages show a much larger drop of 76 percent. The survey also showed that 71 percent of respondents experienced a drop in income in the fourth quarter of 1990, and 37 percent reported negative income. In addition, breaking data out by large versus small marketers (based on the median), shows that small marketers tended to be even more affected than large businesses.

Independent marketers are the competitive lifeblood of the petroleum marketing industry. Most major marketing innovations are the result of an independent marketer trying to build the better mouse trap. With the twin squeezes of scarce capital availability for environmental upgrades and expansion and the aggressive, unfair marketing practices of the major refiners, the viability of the independent segment is being threatened as never before.

The activities of the major oil companies in expanding their marketshare has also hurt marketers in their ability to obtain credit. This has occurred because bankers viewing loan applications from marketers see not only an environmental risk in the applicant but quite possibly a business with eroding sales and profitability as well. Much of this decline in sales and profitability is the direct result of the aggressive, anti-competitive practices engaged in by some suppliers.

In response to what we view as inequities in the marketplace, PMAA, along with other marketing groups, is developing federal legislation that we believe would "level the playing field" in terms of the independents and the majors. We expect that legislation to be introduced before the end of this month.

RECOMMENDATIONS

Mr. Chairman, PMAA offers three recommendations in response to the lender liability problem, especially in connection with petroleum Underground Storage Tanks.

o First, PMAA urges the enactment of S. 651 as amended to include provisions similar to section two of H.R. 1450. As stated earlier in our testimony, H.R. 1450's section two provisions would go a long way in resolving the lender liability problem in connection with RCRA/UST.

o Second, we urge EPA to extend the UST Financial Responsibility deadlines to the end of 1992. This action would allow the 102nd Congress to act on the lender liability problem prior to adjournment.

o Third, PMAA will be urging support for soon-to-be-introduced anti-competitive practices legislation.

Attachment I

PETROLEUM MARKETERS ASSOCIATION OF AMERICA

1991 UNDERGROUND STORAGE TANK ACTIVITY SURVEY

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February 8, 1991

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SUMMARY
PMAA'S 1991 UNDERGROUND STORAGE TANK ACTIVITY SURVEY

PMAA's latest survey on marketer underground storage tank (UST) activity clearly demonstrates the high cost of complying with the Environmental Protection Agency's (EPA)'s financial and technical tank regulations. Marketers face not only financial assurance costs, but also the costs associated with upgrading and replacing USTs, investments in leak detection equipment and testing, and cleanup of contaminated sites. At the same time, marketers are experiencing a contraction in the credit available to the industry as a result of bank fears of environmental liability.

Survey results show that the cost of private pollution liability insurance (PLI) continues to escalate, and that fewer and fewer marketers are able to afford this type of financial assurance. Only 13 percent of marketers currently carry PLI, down from 33 percent one year ago.

At the same time, activity at the state level has afforded many marketers an alternative in the form of an EPA-approved state UST trust fund. Sixty-three percent of marketers are meeting EPA's financial responsibility regulations with an approved state fund, compared with just 6 percent last year. This is the primary reason that the proportion of marketers with no financial assurance has declined, from around 60 percent to 24 percent in just one year.

As the cost of PLI continues to escalate, it moves farther out of reach for the average marketer. The average premium in 1990 was over $37,500, up 92 percent from 1988 and nearly 400 percent compared with 1986 levels. PLI costs are also increasingly regressive, with large marketers paying a per tank average of $456 compared with $1,981 for smaller tank owners.

Marketers also face huge equipment and associated costs. During 1990 and 1991 alone, the average marketer spent nearly $240,000 on equipment. More than one-half also reported engaging in cleanup activities, with the cost per marketer averaging nearly $148,000.

As marketer financing needs grow, so do their problems with financial institutions. Of the 44 percent of marketers who have applied for financing for an UST-related activity, one-third have been rejected. In the vast majority of these cases, banks have indicated environmental liability concerns as the reason for the denial.

Given the difficulties that marketers are encountering in attempting to comply with EPA's technical and financial UST regulations, it is not surprising that marketers continue to close service stations. Survey results suggest that between 1989 and 1992, 28 percent of total surveyed stations will have closed as a result of EPA's UST regulations.

EPA's one-year delay in its financial responsibility compliance deadlines for certain UST owner/operators has facilitated the development of more state funds and thus improved the financial assurance coverage of this nation's independent petroleum marketers. At the same time, the increased reliance on state funds means that a substantial number of marketers is without coverage by virtue of their geographic location. More time is needed for additional funds to be developed and for EPA to review those already submitted.

PETROLEUM MARKETERS ASSOCIATION OF AMERICA
1991 UNDERGROUND STORAGE TANK ACTIVITY SURVEY

INTRODUCTION

The 1991 Underground Storage Tank Activity Survey is PMAA's fifth survey in less than 3 years that addresses marketer activity with respect to their underground petroleum storage tanks (USTs). The ongoing study of this issue is designed to assess the impacts, over time, of the Environmental Protection Agency's (EPA)'s financial and technical UST regulations. While previous efforts have focused on the financial assurance status of petroleum marketers, this survey was expanded to include data on tank and cleanup expenditures, as well as financing issues.

SURVEY RESPONSE

PMAA's 1991 UST survey was sent to 2000 randomly selected marketers across the country. Responses were received from nearly 300 marketers operating in 45 states.

TABLE 1: DISTRIBUTION OF SURVEY DATA BY MARKETER SIZE

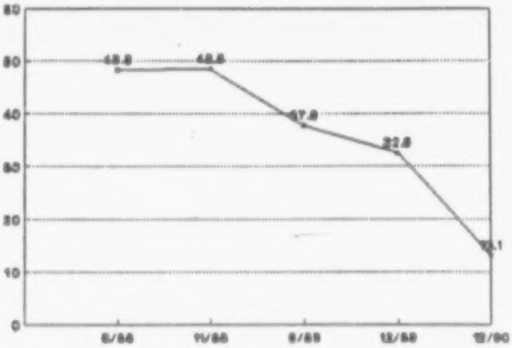
	ALL	Owners of 100+ USTs	Owners of 13-99 USTs	Owners of ≤13 USTs
Survey Responses(%)	100.0	10.1	53.8	36.1
Total Tanks(%)	100.0	45.5	47.0	4.8
Total Outlets(%)	100.0	47.4	49.7	5.6
Total Sales(%)	100.0	38.4	53.5	8.1
Average Tanks Owned	45.2	204.1	41.8	6.0
Average Outlets Owned	11.4	56.1	9.8	1.8
Average Sales (MMG)	10.8	39.5	10.8	2.5

As shown in Table 1, survey respondents report owning an average of 45 USTs, 11 retail gasoline outlets and sell an average of nearly 11 million gallons of motor fuel annually. Large marketers, those with more than 100 USTs, accounted for only 10 percent of total survey responses but over 45 percent of total surveyed tanks. Conversely, the smallest marketers own less than 5 percent of total tanks but account for over one-third of surveys received.

INSURANCE COVERAGE

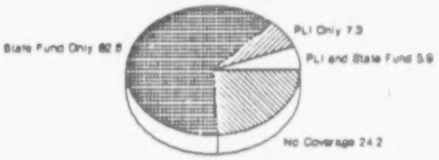
As PLI costs continue to escalate, marketers are becoming more and more reliant on state funds for financial assurance.[1] As illustrated in Figure 1, only 13 percent of marketers report carrying a private PLI at the end of 1990, compared with nearly one-half in 1988.

Figure 1: Percent of Marketers with Pollution Liability Insurance June 1988-December 1990



At the same time, the growth in legitimate state funds[2] has vastly increased the number of marketers with some type of financial assurance. Figure 2 shows that 63 percent of marketers rely exclusively on a state fund for coverage while another 6 percent are covered by both a state fund and a private policy. Just one year ago, only 6 percent of marketers were covered by an EPA-approved state fund. Thus, the proportion of marketers without any financial assurance has dropped from around 60 percent in December 1989 to just 24 percent in December 1990.

Figure 2: Financial Assurance Coverage of UST Owners, 1990 (Percent of Marketers)



Only 7 percent of the largest tank owners are without any form of financial assurance, as illustrated in Figure 3. Unexpectedly, marketers in this category are more likely to be covered by a state fund and somewhat less likely to have a private insurance policy. Twenty-three percent of marketers in the 13-99 tank category are currently without

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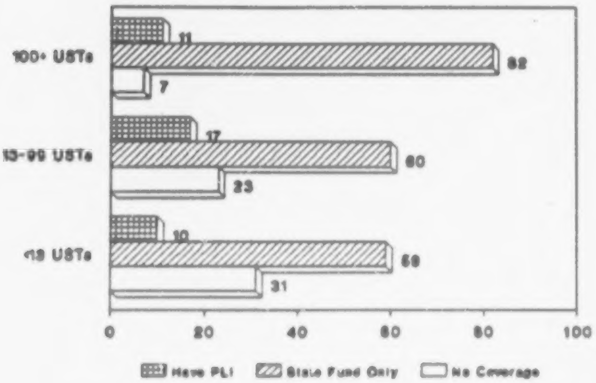
[1] Although technically marketers can satisfy EPA's financial responsibility requirements in a variety of other ways, such as self-insurance and letters of credit, this is a viable option for only the largest businesses.

[2] Legitimate state fund is defined here as one that has either already gained EPA approval, or a fund that has been submitted to EPA but has not yet been approved; marketers relying on the latter type of fund are considered in compliance with EPA's regulations until final determination of their fund's approval status.

Figure 3: Financial Assurance Coverage by Marketer Size, 1990



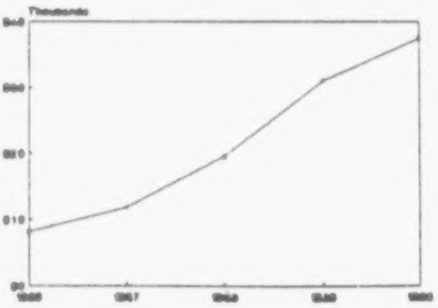
coverage, and almost one-third of the smallest marketers have no financial assurance.

Despite the emergence of the state fund option for a majority of marketers, the average business continues to expend considerable amounts of time in the effort to secure or retain coverage. Respondents report that over the past year, they personally have spent an average of 40 hours and their employees, agents and others have expended an additional 48 hours in the effort to obtain or retain coverage.

INSURANCE COMPANIES AND COSTS

Pollution liability insurance costs continue their upward spiral, despite the emergence of several new insurers. As shown in Figure 4, insured marketers paid an average of over $37,500 in 1990 PLI premiums. This represents an increase of 92 percent from the 1988 average of $19,500, and is up nearly 400 percent compared with 1986.

Figure 4: Average PLI Premium Costs, 1986-1990



Insurance costs are also increasingly regressive. In 1990, large tank owners faced per tank PLI costs of under $500. Owners of 13-99 tanks reported PLI costs averaging $1,451 per tank, and the smallest marketer paid a per tank average of almost $3,300, as illustrated in Table 2. Thus, the small marketer incurred a cost of over 1 cent per gallon compared with only 0.17 cents for larger businesses.

TABLE 2: INSURANCE COSTS BY MARKETER SIZE, 1990

	ALL	Owners of 100+ USTs	Owners of <100 USTs	Owners of <13 USTs
Cost per tank($)	1,811	456	1,451	3,267
Cost per site($)	5,025	1,166	4,493	7,971
Cost per gallon(c)	0.58	0.17	0.40	1.19

Although new insurers have entered the marketplace over the past year, the PLI market continues to be concentrated. Federated accounted for 37 percent of policies reported (down from 58 percent one year ago) while Agricultural Excess and Lloyd's of London accounted for 16 percent each. The remaining 31 percent named a handful of miscellaneous companies as their insurers.

UNINSURED MARKETERS

Uninsured marketers were asked to explain their primary reasons for not carrying PLI. The growing importance of state funds is evident in the responses to this question; 63 percent of the uninsured indicated use of another means of financial assurance (nearly all are using state funds) as a major reason for not carrying PLI, compared with just 38 percent one year ago (Table 3).

TABLE 3: REASONS FOR NOT CARRYING PLI, 1989-1990
(Percent of Marketers with No PLI)*

	1990	1989
Use Other Means**	63	38
Can't Afford Premium	51	66
PLI Not Available	20	15
Tanks Not Insurable	13	23

* Columns sum to more than 100 because multiple responses were given.
** Primarily state funds. Includes marketers relying on unapproved state funds.

Fifty-one percent said that affordability was a primary reason, down from two-thirds in 1989. (Given the large increases in PLI costs, this is less indicative of insurance becoming affordable, and more an indication that state funds are providing a viable alternative). More respondents, 20 percent compared with 15 percent last year, said that PLI is not available in their market. Only 13 percent said that their tanks failed to meet the insurer's underwriting requirements, compared with 23 percent one year ago.

Marketers who indicated that insurance is "unaffordable" were asked to further define this term, with the following results: competitive conditions will not allow costs to be passed through-

39%; the premium cost is too large a percentage of annual income <and in some cases it exceeds annual income>-31%; do not have the financial resources to pay the insurance premiums-14%. The remaining 16 percent selected multiple responses.

EQUIPMENT COSTS

The need to qualify for financial assurance has accelerated the timetable for equipment upgrades, and the vast majority of marketers report spending considerable sums on tanks and leak detection equipment and testing.

TABLE 4: UST EQUIPMENT EXPENDITURES, 1990-1991

	Average Expense	Percent of Marketers Making Investment
1990:		
Tank Upgrades	$132,871	73.0
Leak Detection	27,890	73.7
1991:		
Tank Upgrades	120,939	67.2
Leak Detection	28,068	69.3
Two-Year Average	239,091	87.7

As illustrated in Table 4, 88 percent of respondents reported that they will invest an average of over $239,000 each on UST equipment during 1990 and 1991. This translates into an annual expense of 2 cents per gallon or $4,000 per UST over this two-year period. Since UST investment activity has been ongoing for a number of years and will likely continue for years to come, these estimates provide only a snapshot of UST expenditures; obviously the total cost of EPA's UST regulations will be much higher in the long term.

CLEANUP COSTS

As expenditures on UST equipment increases, so does the need to clean up any contamination discovered in the process. Fifty-one percent of respondents have commenced or conducted a tank/site cleanup over the past year, compared with just 31 percent in 1989. The majority of marketers, therefore, is faced with not only equipment costs, but also the costs associated with cleanups.

The average respondent engaging in a cleanup reports spending a total of $147,564 on tank/site cleanups. Of that amount, assessment costs account for $34,302 and actual cleanup costs make up the remaining $113,256. This translates into a per gallon expenditure of 1.9 cents. Although these costs are substantial for the individual marketer, they clearly fall far short of the million dollar cleanup situations envisioned by some regulators.

Because most marketers engaging in cleanup activity also reported cleaning up more than one site, per marketer costs do not represent average cleanup costs. Per site cleanup costs averaged just $53,750, including $11,404 for assessments and $42,346 for remediation. In fact, in 12 percent of the cases cited, marketers reported incurring substantial assessment costs (averaging $18,000) but did not expend funds for actual cleanup.

In addition to cost, bureaucratic delays have become an increasing impediment to the conduct of timely assessments and remediations. Two-thirds of the marketers who have conducted a cleanup report experiencing some type of delay with the tank implementing agency. Specifically, marketers report delays in:

Plan review and approval	50.3%
Closure review and approval	48.6%
Review of sample analysis	40.9%
Site inspection	38.3%
Permit approval	37.6%

FINANCING

It is clear that marketers are incurring extraordinary costs in the effort to comply with all of EPA's UST regulations. At the same time that the capital investment needs of the industry are mushrooming, however, marketers are finding financing increasingly difficult to obtain. This is largely because financial institutions are more and more reluctant to finance any activity related to USTs for fear of being held liable for environmental damage in the event of a default.

Forty-four percent of the marketers responding to PMAA's survey reported making at least one application for financing over the past two years for some type of UST activity, and fully one-third of these applications were denied.

TABLE 5: MARKETER APPLICATIONS FOR FINANCING, BY TYPE OF ACTIVITY

	% Applying for financing	% Applications Denied
Tank Upgrade/ Replacement	40	32
Leak Detection	23	21
Cleanup	13	36

More specifically, as shown above, 40 percent of marketers have applied for financing for a tank upgrade/replacement, and 32 percent of these applications have been denied. Although only 13 percent of marketers have attempted to finance a cleanup, 36 percent of these applications were denied.

Asked to explain the reasons that their banks denied their applications, more than three-quarters of the responses specifically named environmental liability concerns on the part of the financial institution. Sixteen percent were told that their businesses were not deemed "healthy" enough by the lending institution, and the remaining miscellaneous responses included bank fears about the Persian Gulf war, new bank policy against loans to petroleum companies, and "impossible" loan terms.

Among marketers able to secure financing, there are widespread reports of new and more stringent conditions. Respondents report that, over the past two years, their banks have imposed the following loan new terms:

Environmental Site Assessment	44%
Personal Guarantee for Environmental Matters	32%
Other Environmental Concerns in Loan Agreement	30%
Lender's Ability to Substitute Collateral	27%
Site or Tank Cleanup Prior to Loan	23%

Ultimately it is impossible to gauge the full extent and impact of the increased tightening of credit for petroleum marketers. Although less than one-half of marketers report applying for UST financing, a number of marketers indicated that they had not applied for credit specifically because their banks had already informed them that it would be denied. Others report that banks have reduced financing available by decreasing lines of credit and shortening loan terms.

Although difficult to quantify, it is clear that bank liability concerns and the parallel decrease in financing have been detrimental to an industry that depends on loans to conduct its business. Not only do marketers face insufficient capital to make the large investments needed to comply with EPA's UST requirements, many have also had difficulty obtaining the working capital needed to conduct day-to-day operations.

STATION CLOSURES

In response to the high cost of complying with EPA's regulations, marketers continue to close substantial numbers of retail gasoline outlets. Forty-nine percent of marketers said that they have closed stations over the past two years, with the closure rate averaging 4 outlets. Forty-six percent said that they will close an average of three more stations each over the next two years.

In sum, survey results indicate that at the end of the four-year period ending in 1992, nearly 28 percent of total surveyed stations will have closed as a result of EPA's upgrade and/or insurance regulations. Thus, the decline in the service station population that has occurred over the past several years should be expected to continue for several years to come.

Attachment II

PMAA
PETROLEUM MARKETERS ASSOCIATION OF AMERICA
1120 VERMONT AVE., NW • SUITE 1130 • WASHINGTON, DC 20005 • (202) 331-1198

July 13, 1989

Ronald Brand, Director
Office of Underground Storage Tanks
U. S. Environmental Protection Agency
401 M St., SW, Room 2106
Washington, DC 20460

Dear Ron:

The Petroleum Marketers Association of America (PMAA) is concerned about increasing reports received from independent petroleum marketers in several states that their lending institutions are unwilling to make loans for underground petroleum storage tank purposes, including upgrades, replacements or remediation of releases. According to these reports, this unwillingness is based upon the lenders' concern about the potential liabilities they face as secured creditors in underground petroleum storage tank sites. We believe this concern is due in part to generalized fears about Superfund liability which reflect an unawareness of the substantial and important differences between the LUST Trust Fund and Superfund. A recent environmental guide published by the America Bankers Association articulates these fears as follows:

> For many years, industrial and other commercial entities have stored heating oil, gasoline, solvents and other chemicals in tanks located beneath the ground. In recent years it has become apparent that many of these tanks have leaked. Congress responded to public concern about this problem by requiring EPA to regulate underground storage tanks. The regulations impose construction, installation, leak monitoring, insurance and financial responsibility requirements for underground tanks.
>
> Additionally, Congress provided $500 million to EPA to pay for a government cleanup of past leaks from such tanks. EPA is empowered to recover the costs of these cleanups from the parties legally responsible for the leaks. The present owner or operator may be liable for this cleanup even if it was unaware that the tanks existed. *Government agencies and courts are likely to construe this part of RCRA as broadly as Superfund and may extend liability to lenders, particularly if there is no other party available to pay the costs**. (Emphasis added.)

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* *Managing Environmental Risk: A Practical Guide for Bankers*, American Bankers Association (1989).

As you know, Congress was aware of lenders' Superfund-related fears when it established the LUST Trust Fund in 1986. Accordingly, it defined the term "owner" to exclude "any person who, without participating in the management of an underground storage tank and otherwise is not engaged in petroleum production, refining and marketing, holds indicia of ownership primarily to protect such owner's security in the tank." (42 U.S.C. 6991b) Thus, a bank or other lending institution that meets these simple conditions (i.e., is not engaged in the management of an underground storage tank, etc.) is not subject to cost recovery under the LUST Trust Fund. It would seem, therefore, that fears that the courts would extend liability to lenders for cleanup of underground petroleum storage tank releases under the LUST Trust Fund are not well founded.

Although the LUST Trust Fund contains language specifically designed to assure lenders that they will not be subject to "Superfund-type" liability associated with a security interest in an underground petroleum storage tank site, PMAA is concerned that certain ambiguities contained in 40 CFR Parts 280 and 281 give rise to what appear to be legitimate questions about lender liability under the underground tank regulations themselves. For example, Section 280.12 defines the term "owner" more broadly than and without reference to the protective statutory language applicable to lending institutions:

> "(a) In the case of an UST system in use on November 8, 1984, or brought into use after that date, ["owner" means] any person who owns an UST system used for storage, use, or dispensing of regulated substances; and
>
> (b) In the case of any UST system in use before November 8, 1984, but no longer in use on that date, ["owner" means] any person who owned such UST immediately before the discontinuation of its use."

Under 40 CFR Parts 280 and 281, "owners" of underground storage tanks share with "operators" compliance responsibilities associated with all aspects of the technical and financial responsibility requirements, including Subpart F, Corrective Action directives. Conceivably then, the regulations could be interpreted as requiring a lender, who has become an "owner" of an underground petroleum storage tank site based upon the exercise of its security interest only, to report any release to the implementing agency under Section 280.61 and comply with other release response and corrective action requirements under this Subpart. As an "owner" under the regulations, the lender could also be subject to a cleanup order issued by the EPA or the implementing agency. In such a case, the lender would be forced to choose between refusing the order on the one hand, or complying on the other. If the lender complies, then it actually becomes involved in the management of the site, making it ineligible for the unique protected status accorded to lenders holding a mere security interest under the LUST Trust Fund. If it refuses, it preserves its protected status but risks, among other things, public criticism.

This result is surely not what Congress intended when it sought to protect those who hold indicia of ownership primarily to protect their security interest in a tank site.

In view of the above, PMAA respectfully requests that EPA issue a statement of clarification concerning lender liability under the underground storage tank regulations. Like the LUST Trust Fund, this statement should make clear that EPA will not seek cost recovery from lenders not engaged in petroleum production, refining and marketing and who do not participate in the management of an underground storage tank. The statement should also elucidate such a lender's responsibilities under 40 CFR Parts 280 and 281. Since one of the primary objectives of cost recovery under the LUST Trust Fund "is to provide incentives for owners and operators to comply with technical and financial responsibility requirements" (Cost Recovery Policy for the Leaking Underground Storage Tank Trust Fund, OSWER Directive 9610.10, October 7, 1988) we would submit that it makes little sense to subject such a lender protected under the LUST Trust Fund to the requirements of Parts 280 and 281.

Without such a clarification, we believe that the problems marketers are experiencing with their lenders will certainly become worse. Those who cannot obtain financial assistance will not be able to upgrade their tanks, and those who cannot upgrade their tanks will find it very difficult, if not impossible, to obtain insurance. Leaving the issue for the courts to decide is no solution, since the prospect of litigation and uncertainty is precisely what lenders are seeking to avoid in refusing to make loans for underground storage tank purposes. EPA has the authority to clarify this issue.

In closing, we are, as always, grateful for the openness and willingness you and your staff have consistently displayed in hearing and responding to our concerns about the underground storage tank program. We appreciate this opportunity to provide you with additional recommendations to address what is rapidly becoming a critical problem.

Sincerely,

Barbara Faulkner

Barbara Faulkner
Vice President,
Policy and Legal Affairs

BF:mt

Senator **Garn**. Thank you, Mr. Adcox.

Gentlemen, I appreciate all of your testimony.

Mr. Wolf, I want you to understand that my comments to you are not personal in any way. I don't know you. I have never seen you before. So I want you to understand that.

Mr. **Wolf**. OK. I'm used to it, Senator.

Senator **Garn**. But I am really puzzled. In the 17 years that I have been in this body, I have dealt with a lot of contentious and controversial issues. And usually, at the outset, you are aware of where the opposition will be and the differences of opinion. And certainly after 17 years in this body, you learn that you can't have your own way and that, fortunately, the legislative body was set up with checks and balances so that all people can be heard, and you expect opposition.

But before I introduced my first bill last year, I thought this was one that, with all my experience, that was so clean-cut, that all I had to do was introduce it and it would pass, because we were simply trying to go back and reaffirm what Congress had done on two occasions before.

And as I said without repeating myself, I do not understand the logic of the judges in totally ignoring what was clearly the intent of a vast majority of 535 representatives of the people of this country.

Now they could sit there in the 11th Circuit and could say, hey, we interpret this differently. It's very clear.

Even in the testimony of last year, statements of how this language took care of it, the exemptions.

Well, it doesn't because of the court interpretations, if they had been left alone. And no one that has ever testified, or this Senator or anybody that I know, does not want to clean up the problem. That is not at issue. It is not an environmental issue. It is a fairness and who pays for it issue.

Your figures I have no basis to dispute. But I frankly would be rather embarrassed to present them because they don't present the picture. You're old enough and have been around long enough, I assume, in your practice of law to know that perception is reality. And I don't really care what your figures show because they do not indicate what you've had every Federal regulator testify to, that people who are responsible and the ones who are out there working and the anecdotal stories from all over this country are correct.

There's an incredible chilling effect.

And I think the environmental community on this issue discredits themselves and their credibility. And you go back to the letters that were written last year and talk about creating Love Canals and more pollution and so on—ridiculous, signed by 11 different, 10 or 11 different, all the environmental groups got together.

All of you have a right to your opinion and I don't dispute that. I asked everybody last fall, we've got a problem. Let's solve it. Bring in your input.

But to make this an environmental issue and to put out the propaganda that was put out is very disheartening to me, whether it was from your group or any other groups.

And occasionally, we get that kind of testimony, even on issues that I agree with the proponents. Their testimony isn't factual. It doesn't relate to the issues. And so you just kind of discount it.

Rather than trying to be helpful, to ignore all of this testimony from so many different groups, and the John LaFalces of this world who are certainly known as environmentalists. I am not. And I freely admit that and my record shows that. I happen to think that I'm an environmentalist, but you would not interpret it that way. Well, that's fine.

But I am really disappointed that the environmental community is blocking an issue, or at least attempting to, that has been so vitally needed because I've never had such unanimous testimony on the other side from so many diverse groups, except the environmental community.

So I guess my question is why can't we separate, why can't we separate the environmental issue and agree that that isn't the issue?

I don't want to pollute. I don't want dirty ground sitting around. I don't want people's health injured. But also, I can't sit back on top of a $150 billion problem that all of you talked about and listen to a Bill Seidman and Treasury and EPA and everybody else say this is a serious problem, and individual bankers, and even the American Bar Association—my goodness. The American Bar Association.

I would seek your cooperation. If you don't like the language, just quit blindly opposing and come in and tell us how we can solve the problem.

My legislation as the result of environmental communications was dramatically narrowed. I don't know whether you listened to the testimony of the Fed, but theirs said it's too narrow, that it doesn't give a broad enough exemption.

I did that to try and be balanced and responsible so that no bank could make a profit. No innocent lender could make a profit as a result of somebody cleaning it up.

But how you can defend a system, one in Texas that a bank repossessed a piece of property in 1948 for 3 months, and in 1989 or 1990, they went back through the whole chain of owners and they were the only one that they could find.

In America, we can't defend that, that somebody repossessed for 3 months in 1948, 40 years ago, and they're supposed to go in and clean up what somebody else did in the meantime? Unbelievable. Just unbelievable.

So, again, my remarks are not directed at you and I don't mean them personally in any way whatsoever. But I would ask for some responsibility from the environmental community and not these ridiculous letters of July 1990. They're just filled with lies, that my legislation has nothing to do with. It wouldn't create any more Love Canals, wouldn't create a drop of pollution any place.

That isn't what I hear. Your own statement, you consistently characterize lenders and other parties covered by my legislation as polluters.

Harris Simmons is not a polluter. He had nothing to do with that Toyota dealership and their leaking tanks. Nothing whatsoever. In fact, I don't even think he was president of the bank at the time that that took place, or the loan was made. In fact, I'm sure you were not.

It isn't their fault. It isn't the depositors' fault of Zions Bancorporation. It isn't their responsibility to pay higher premiums for their FDIC insurance because of what a Toyota dealership did.

And if we can't get the owners and the polluters, then you go back to the superfund. But not to innocent people. It's just a concept—like I said, in 17 years, I've never been involved in an issue, and I simply didn't understand the opposition's position at all. And I've reexamined mine over and over again. I've gathered more testimony. I've sought more input.

Do you have any explanation of why we can't separate the legal issues from the issue of pollution? Do you think my bill adds to pollution? Do you think it's going to encourage pollution? Do you want us to sit there with the question I ask about what happens when they walk away from it? Zions would have been better off to say, the heck with it. Let it sit there. They spent $440,000 trying to clean it up, something they didn't do. They would have been better off, they weren't responsible, to walk away from it and let it sit there polluted.

It is cleaned up now. And I would suggest from an environmental standpoint that my legislation would help the environmental side because if I were one of those, I'd walk away from it. I wouldn't make loans in a lot of areas, and that is the reality. That is the reality of it.

Mr. **Wolf**. Well, let me say that I agree with much of what you are saying, Senator, in the sense that we believe that it's important to have incentives so that there won't be pollution in the future.

And let me also note that I do appreciate, and I know that others in the environmental community appreciate the changes you've made to your legislation, taking into account some of the concerns that we and others have raised.

It does show that you have a strong interest in trying to resolve this contentious problem.

I would say that we aren't the only sector of the public that has concerns with this type of legislation, however. The Chemical Manufacturers Association, for example, testified I believe before the House last year to the effect that there are aspects of the superfund program that they do not like many, I'm sure. But they feel that it's important to treat all individuals who come under the net of superfund liability equally, because one of the things that the superfund statute does do is it does bring together all the parties who are associated with the site and allow them with EPA to work out those environmental problems.

I do agree that it makes no sense to charge innocent people with the cost of cleaning up the site. I think that where we may disagree is as to what is an innocent party.

And if I could for a minute, I refer to the future——

Senator **Garn**. I'd just interject before you leave the chemical manufacturers.

Mr. **Wolf**. Sure.

Senator **Garn**. The reason they don't like it is because they're not included in my bill. That's why. They would like to be added.

Mr. **Wolf**. I'd be glad to ask someone—I think there's someone from CMA here. Maybe they could comment on that.

We're talking about a lot of the problems of the past today. I don't want to escape that. But I would like to say that when you've looked toward the future, one of the beneficial aspects of the superfund liability standards is that it does change the way the future is going to look as far as environmental problems are concerned.

What banks do now is before they make a loan, they send out questionnaires. They require environmental audits. Once they undertake a loan, they take many steps to police the quality of their collateral.

But more than just police the quality of their collateral, they're worried about being in the position that some of the bankers that Mr. Simmons has described are in. They foreclosed on the site and now they're the owner-operator. And that's an unenviable position. I do understand why people would not want to foreclose. And so there is this strong incentive on the part of the banks to not only police the value of their collateral, but to pay attention to the practices that the borrower is—the waste-handling practices, the industrial practices that the borrower uses.

And it's this sort of pressure that is changing the way industry conducts its business.

I went to a conference just a week ago on pollution prevention, which is an important topic. I think everyone would be interested in that topic. The question is how can industry change the way it does business so it uses less toxic chemicals and therefore, there's less toxic waste at the end?

There are some dramatic success stories.

Senator GARN. Mr. Wolf, I don't disagree with you. But prevention is a different issue. We're talking about going back and picking up the past as you referred to, and punishing them.

Now I cannot believe that we cannot solve that problem.

Mr. WOLF. I agree.

Senator GARN. Because, I'll guarantee you, the financial community does not want to repeat what has taken place in the past. They are as interested as you in preventing so that they are not even involved with this situation.

So I understand and I don't disagree with what you're saying. But let's not confuse that with correcting those errors of the past which pick up scapegoats like Mr. Simmons and his organization.

That's what I'm pleading for. That's what I'm asking for, some help in making that distinction. And if you'll do that, then you'll have my help in the prevention.

Mr. WOLF. As far as the Fleet factor situation, which is what started all this discussion, I suppose, in Fleet factors, you had a bank that was really in many ways running the company. And I think that that's not the typical situation. But when you do have a bank that is instructing the borrower to do things that are not sound environmentally, that lead to environmental pollution, then it's important that there be superfund liability for those types of actions.

I don't think that we disagree on that. I think that where we might disagree is where you draw the line. And that's a difficult process.

You'll note that in my testimony, I raise some issues about the wording of S. 651. I don't mean to attack your staff. I'm sure your staff does a very good job. But you mentioned at the outset your concerns about lawyers. And speaking as a lawyer, I'm not here to defend that group. Maybe Mr. Forte would like to.

But what we do know is that lawyers are able to find how many angels can dance on the head of a pin or maybe they can argue about that for a long time. If we do not carefully define exactly what the dividing line is between policing your collateral and actually divesting control from the borrower, then we're going to still continue to have the same problem.

I think that what EPA is doing, although it does not provide the immediate certainty that many in the lending community would like, is really a valuable process. They are setting out a lot of different scenarios in the preamble to the proposed rule. They are setting out examples. And I think that as they receive comment on the proposed rule, once the rule goes final, that sort of approach gives much more certainty because it does more than a bill can do.

A bill—you've got the wording and the wording is pretty sparse and then you've got some legislative history, and that's not always very clear, either.

Senator GARN. Are you aware that both mine and Congressman LaFalce's bill preceded Fleet factors?

Mr. WOLF. I stand corrected, then, or sit corrected. I know that there was a string of cases, the Maryland case and others, that led to this concern.

Senator GARN. Well, my concern was before Fleet factors even took place. And that's why I introduced my bill.

Mr. WOLF. I think that's very farsighted. I do think that we still have perhaps a disagreement about when to draw the line between when a lender becomes involved in the day-to-day operations or has the capacity to influence and whether that——

Senator GARN. Let me ask both you and Mr. Forte, looking at Fleet factors and the Maryland decision and others, if they can be interpreted the way they were, then why in the world should we assume that, particularly in the 11th Circuit, that an EPA rule is going to be interpreted any differently than they interpreted the law.

Mr. Forte, do you have something on that?

Mr. FORTE. I said at the end of my presentation, Senator Garn, I agree with you 100 percent. I don't think the EPA is going to be accorded any greater weight than the courts accorded the Congress. And if we make it a little clearer what was already clear, I think they may get the point.

The 11th Circuit—the problem with the 11th Circuit decision is the best posture for a lender is to ignore the problem and walk away, which means that taxes will go unpaid and after that, it will be assumed by the State, and the State will wind up owning the property and the State now has got the cleanup problem.

Senator GARN. Let me just make another comment.

At last year's hearing, I issued a public invitation to our witnesses and any others who wanted to reply for your comments and to work with us to resolve these issues in a fair and a balanced way.

For those who took me up on that, I appreciate it very much. I would say, however, Mr. Wolf, that beginning in December 1989, because that's when I started, we have consistently asked for input from the environmental groups and have essentially been stonewalled.

Now you appear to be reasonable today and asking about some of these things. I realize that there are gray areas. And then when you get into the legal technicalities of what is an innocent lender, fine. I think I have showed good faith without your input to narrow it to go to some of the concerns that I was aware of, again, to limit the possibility of profit, only to keep banks whole.

But I would really ask, rather than being stonewalled, for some help, to come in and sit down with my staff and talk about these issues and see if we can define it. Because without that, this bill is going to come up one way or another. If I can't break it out of the committees, there will be some choice vehicles going through because I don't intend to give up on this.

So if you want to be part of the solution, I invite you to do that. Otherwise, at some point, the Senate is going to vote on this on the floor. I will guarantee you that. I've been around here long enough, I know the rules. And just wait around until a late-night session some night when everybody wants to go home for Christmas and the Senate will face this issue.

This session will not end as last year's did, with me being invited to wait for hearings, which I have done for a year and a half now, and have been put off and stalled and stonewalled by certain groups.

So I invite anybody who wants to be to be part of the process and if my staff is in error, my attorneys are in error, fine. I'll talk to your attorneys and we'll see if we'll come to some conclusion.

But we're not going to allow, or this Senator is not going to allow this inequity to continue. It is unfair. It is having a dramatic impact on the credit crunch that so many people are complaining about. It is part of the recession, and the Senate is going to be forced to vote on it one way or another before this session of Congress is over.

Do any of you have any closing comments you'd like to make?

Mr. WOLF. I'll look forward to meeting with your staff, Senator.

Senator GARN. I thank each of you and the hearing is adjourned.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[Response to written questions and additional material supplied for the record:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM EDWARD W. KELLEY, JR.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

EDWARD W. KELLEY, JR.
MEMBER OF THE BOARD

July 12, 1991

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510-6065

Dear Chairman Riegle:

Thank you for your letter of June 20 requesting a response to questions concerning proposed legislation to limit lender liability under the Comprehensive Environmental Response, Compensation, and Liability Act. You will find my responses attached to this letter.

I hope you these comments are useful to you in your consideration of this legislation.

Sincerely,

Edward W Kelley, Jr.

Q1. What is the view of the Board of Governors regarding legislation that would allow Federal financial regulatory agencies that act as liquidating receivers for private lenders to recover their losses first in the liquidation of failed lenders?

A1. Proposals to allow the Federal Deposit Insurance Corporation or the Resolution Trust Corporation to have a first claim on the assets of failed depository institutions have significant implications for both the deposit insurance funds and other creditors of depository institutions. Thus this issue raises questions that go far beyond the issue of environmental liability. The Board believes that this issue can best be evaluated in the broader context of legislation concerning the structure and use of the deposit insurance funds, and should not be viewed in isolation with respect to a single issue such as liability for environmental cleanup costs.

Q2. Is it sufficient that legislation create "safe harbors" that clarify lender actions that do not expose lenders to environmental liability, or is it necessary to go further and limit lenders' losses in the event they incur liability?

A2. We believe that it is important that legislation create safe harbors for lenders by specifying those actions that will not result in CERCLA liability. In order to assure the continuing flow of credit to industries or areas that present risks of CERCLA liability, however, it would also be desirable to limit that liability in the event that a lender must act beyond the shelter of the safe harbor to protect its interest in the repayment of its loan. Under these circumstances it would be appropriate to limit the liability of a lender to the harm it actually caused, rather than subjecting it to liability for all past contamination of the property. Otherwise, fear of exposure to unlimited liability will continue to impede the availability of credit, and the potential for unlimited liability will continue to pose a threat to the health of depository institutions and the deposit insurance funds.

Q3. Does the Board of Governors perceive a need to clarify as well the environmental liability of banks, thrifts, and other persons that act in a fiduciary capacity?

A3. The trust and other fiduciary services provided by banks and other financial institutions are a significant source of potential CERCLA liability. Institutions or individuals serving as trustees or executors may be exposed to CERCLA liability as a result of the management of property or entities held in trusts or estates, even where ownership of a property is passive or where the trustee has contracted out any direct operational responsibilities. While it may be appropriate to treat a fiduciary that is directly and actively managing a facility as the owner or operator of the facility, such treatment is not appropriate for all trustees and fiduciaries. While this source of potential CERCLA liability does not contribute to restrictions in the availability of credit, CERCLA liability resulting from a depository institution's trust and other fiduciary activities could threaten the health of the institution and therefore the deposit insurance funds in the same manner as CERCLA liability from lending activities. This argues strongly in favor of including fiduciaries within the scope of any legislation to limit CERCLA liability.

Further, although most of the information that we have received from the Reserve Banks concerns lending activities, one Reserve Bank has indicated that banks in its region were turning away trust and other related business as a result of fears concerning CERCLA liability. Banks and other fiduciaries provide valuable services to their customers, and this business has traditionally provided a low-risk, stable source of fee income to depository institutions. These services may become increasingly expensive or unavailable unless there is some clarification of the potential liability of fiduciaries under CERCLA.

Q4. What changes in current law would the Board of Governors recommend to clarify the environmental liability of persons acting in a fiduciary capacity?

A4. We would suggest that the liability of fiduciaries parallel the provisions for lenders, so that fiduciaries would be able to undertake a range of activities similar to that permitted for lenders without fear of CERCLA liability. Under such a system, fiduciaries that actively operate a facility would be subject to the same type of liability as lenders causing the release of hazardous substances, i.e., they would be liable for the extent of the harm caused, while fiduciaries that had a passive ownership interest in a business would not be subject to liability.

Fiduciaries that contract out the management of a property or facility would have to be judged on a case by case basis. A fiduciary should not be held liable for the activities of independent contractors, as this would, in effect, subject the fiduciary to liability even though it was not actively involved in the operation of a facility. In such circumstances it may be appropriate to have liability follow the principles of agency law; if the contractor is acting as an agent of the fiduciary, then the fiduciary could be held responsible for the contractor's actions. If management services are provided by independent contractors, however, then the fiduciary should not be held responsible for the actions of the contractor.

Q5. How likely is the realization of risk of environmental liability by the Federal Reserve Banks in the conduct of their lending activities?

A5. The lending functions of the Federal Reserve Banks include providing adjustment credit and acting as a lender of last resort for depository institutions. As a result, the Reserve Banks are exposed indirectly to the same risks of CERCLA liability as the institutions to which they lend. For example, as lender of last resort, a Federal Reserve Bank may advance funds to a depository institution collateralized by the institution's loans, which may in turn be secured by real property. Should the institution fail, the FDIC, as receiver, would likely acquire the loans from the Reserve Bank and would be left holding the loans. In these cases, the FDIC would be exposed to lender liability to the same extent as the original lender. If the FDIC chose not to acquire the loans, however, the Reserve Bank would be subject to this exposure. While the probability that the Reserve Bank would actually incur liability is fairly low and has not occurred to date, the potential for unlimited liability is still a source of concern to the Reserve Banks in their lending activities.

Q6. What procedures do the Federal Reserve Banks follow in their lending activities to avoid or minimize their risk of environmental liability?

A6. With regard to Reserve bank lending procedures, no hard and fast rules have been adopted, as the feasibility any particular set of requirements may vary depending on the institution and the type of property involved. The Reserve Banks are considering several requirements that could protect against CERCLA liability, such as requiring a current environmental audit report for each loan secured by real property, requiring the depository institution to warrant that loans offered as collateral have been subject to environmental audits at origination and continuing environmental monitoring, or examining the depository institution's environmental audit procedures directly. These alternatives may not be feasible in all situations. The Reserve Banks could also refuse to accept as collateral loans secured by property that presents a risk of CERCLA liability, or could require higher levels of collateral relative to the amount of the Reserve Bank's lending in order to avoid the necessity of taking possession of any particular property securing a loan used as collateral.

Q7. What risks of environmental liability are the Federal Reserve Banks most concerned with in their lending to undercapitalized, illiquid, or otherwise distressed financial institutions or other borrowers?

A7. If a depository institution to which a Reserve Bank had lent failed and the Reserve Bank had to rely on repayment from the loans or other assets collateralizing depository institution's borrowing, the Reserve Bank would step into the shoes of the original lender and potentially be exposed to similar liability. The Reserve Banks would therefore be concerned about the same types of loans as any other lending institution.

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8100

Charles J. DiBona
President

June 12, 1991

The Honorable Donald W. Riegle
United States Senate
Chairman
Committee on Banking, Housing
and Urban Affairs
Washington, D.C. 20510

Dear Chairman Riegle:

The American Petroleum Institute (API) is pleased to submit testimony expressing the petroleum industry's concerns with lender liability legislation under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). EPA is attempting to address lender concerns through rulemaking, and the petroleum industry believes that these rulemaking efforts may obviate the need for legislation and should therefore be allowed to work. Consequently, legislative remedies at this time are premature.

You may contact Dr. Terry Yosie of my staff should there be any questions about the content of the testimony. He may be reached at (202) 682-8090.

Sincerely,

TESTIMONY OF THE
AMERICAN PETROLEUM INSTITUTE
ON LENDER LIABILITY
FOR ENVIRONMENTAL CONTAMINATION

SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

JUNE 12, 1991

The American Petroleum Institute (API) appreciates this opportunity to present the industry's views on lender liability for environmental contamination. API is a trade association representing over 250 companies involved in all aspects of the oil and gas industry, including exploration, production, refining, transportation, and marketing.

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980 was enacted to effectuate remediation of abandoned hazardous waste sites through the imposition of strict, joint and several liability on "owners or operators." The definition of owner or operator "[d]oes not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." 42 U.S.C. §9601(20)(A) (Supp. IV 1986). The practical effect of this definition is to exempt lenders from Superfund liability when they are protecting their security interest, unless they "participate in management."

The recent decision in U.S. v. Fleet Factors Corp. has caused some concern within the lending community by including language stating that a lender could be held liable if its participation in management was sufficient to support the inference that it had the "capacity to influence" decisions related to hazardous waste disposal. This language has become the target of much criticism and concern from the lending community as it is seen to completely erode their current "secured creditor exemption" within the definition of "owner or operator." As a result, lenders claim that they are reluctant to make loans, and that the unavailability of credit, particularly for small businesses will be devastating for an already fragile economy.

A number of federal agencies, particularly the Resolution Trust Corporation (RTC) and Federal Deposit Insurance Corp. (FDIC), have also voiced some concerns. With respect to the RTC, the claim is that they are unable to carry out their mission of selling properties associated with the savings and loan bailout due to the fear created by Fleet Factors.

The result of the current lender liability debate has been the introduction of federal legislation as well as the development of an EPA proposed rule, all purporting to "clarify" the secured creditor exemption of CERCLA.

API and its members support EPA efforts to promulgate a rule clarifying the secured creditor exemption and the scope of permissible activities that a lender may undertake to protect their security interest, while still staying within the bounds of the exemption. Given EPA's current rule-making efforts, API believes that legislative fixes are premature, and may in fact be unnecessary to address the lenders' concerns.

API's position is supported by several factors. First, virtually all of our members who responded to an informal poll on this issue indicated that they had not encountered difficulties obtaining financing to buy properties. There was also no indication that many problems were being encountered relative to third parties obtaining financing to purchase API member company property.

Second, there is no hard evidence of a significant impact on the lending community as a result of recent court holdings. To date the lenders have only provided anecdotal evidence regarding the purported difficulties businesses are experiencing in obtaining financing. Additionally, lenders have not presented any data showing that they are potentially responsible parties at Superfund sites. In fact, a recent study shows that lenders have been held as PRPs at a very small percentage of Superfund sites. (See Study on Superfund Lender Liability, Southern Finance Project (1990)).

Third, it appears that currently proposed legislation would grant a total exemption to lenders from CERCLA liability (H.R. 1450 also includes an exemption for RCRA) or create significant loopholes (e.g. trusts), contravening the Congressional intent of CERCLA. Although CERCLA is touted as a "polluter pays" scheme of imposing liability, this is certainly not always the case. In a number of instances innocent parties are held as PRPs because of the purchase of property that had unknown contamination. Lenders are sufficiently protected from this type of scenario (with respect to protecting their interests) by the existing statutory language.

Fourth, exempting lenders through the legislative process would open the door for other special interests seeking similar exemptions from CERCLA liability (e.g. municipalities and insurers). The untenable result could leave industry as the sole remaining PRP.

Fifth, exempting lenders from all liability creates the potential for situations to arise where the lender is able to obtain a windfall from the sale of property that was cleaned up by the government. By virtue of the expanded exemption as proposed in legislation, a lender that may have sufficiently "participated in management" of a Superfund site will not be liable for cleanup costs. If no other PRPs exist, the cleanup is paid for out of the Fund. The ripple effect of this is an increased burden on the Fund and, to the extent the Fund is appropriated monies from general revenues, on the taxpayer.

Ultimately, the current scope of the exemption benefits the environment. Lenders are now requiring borrowers to conduct environmental assessments or audits of properties, or in some instances, are conducting the audits themselves. Such procedures aid in both identifying problem sites that would otherwise go unnoticed, and, allow the lenders to underwrite environmental risks that accurately account for site conditions. Under the proposed legislation, lenders may be less inclined to encourage environmental assessments or audits given their lack of potential exposure to liability.

In conclusion, API and its members believe that legislation addressing lender liability is premature and may in fact be unnecessary. API believes EPA's recent efforts to clarify CERCLA's existing secured creditor exemption should be allowed to proceed in lieu of legislative activity.

STATEMENT OF THE MORTGAGE INSURANCE COMPANIES OF AMERICA SUBMITTED FOR THE HEARING RECORD ON LENDER LIABILITY

JUNE 12, 1991

SUZANNE C. HUTCHINSON
EXECUTIVE VICE PRESIDENT
MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. Chairman, the Mortgage Insurance Companies of America (MICA) appreciates this opportunity to submit a statement for the hearing record on liability for the cleanup of hazardous wastes. MICA supports the work being done to limit liability under Superfund. However, we are concerned that S.651 does not contain language to also exempt mortgage insurers from liability. The purpose of this statement is to explain the role of mortgage insurance in the housing finance system and to request that specific language be included in S.651 to cover mortgage insurers.

What is Private Mortgage Insurance?

Private mortgage insurance is designed to protect lenders from losses on conventional first mortgage loans made to home buyers who make relatively small down payments, generally 5 percent to 15 percent of the purchase price. Lenders typically require mortgage insurance on low down payment loans because experience and studies show that a borrower with less than 20 percent invested in a house is more likely to default on a mortgage. Mortgage insurers protect against the losses associated with defaults on these loans by guaranteeing payment to the lender of the top 20 percent to 25 percent of the loan amount. In effect, the mortgage insurance company shares the risk of foreclosure with the lender.

The insurance payments provided to the lending institutions when default occurs minimize their losses. Without mortgage insurance, simple analysis shows that lenders would suffer losses on defaulting loans with high loan-to-value ratios. Interest accumulates during the delinquent period, as well as during foreclosure proceedings. Other costs include legal fees, reconditioning expenses, real estate brokers' fees and other closing costs. These expenses normally run 12 percent to 20 percent of the loan amount. Also, there is the market risk of selling the property for less than its original sales price, adding to the potential loss.

The mortgage insurer's customer is the lender or investor. The mortgage insurer has no contact with the borrower or the property. In evaluating whether to insure an individual loan, the insurer receives a package of papers from the lender which generally consists of the terms of the loan, the credit and financial information on the borrower, and the appraisal of the property. The mortgage insurer has no management responsibilities over the property until foreclosure is completed. In fact, the mortgage insurer does not see the property until foreclosure is completed if it exercises the option to take title to the property.

Mortgage Insurers Should Be Treated Equally With Lenders

S.651 recognizes that the original Superfund legislation was not meant to make it difficult for businesses or families to find credit. Lending institutions that have no management responsibilities over property should not be held liable for the cleanup of hazardous wastes when they simple take title to property pursuant to a security interest. If lenders are forced to pay for cleanups under these circumstances, credit will be hard to find in areas near hazardous waste sites. Potential home buyers and small businesses will suffer.

The same rationale used to exempt lenders is applicable to mortgage insurers. In the ordinary course of its business, a mortgage insurer can take title to property, but as discussed above, the mortgage insurer has no management responsibilities until foreclosure takes place and it exercises the option to take title to the property. In fact, the mortgage insurer never sees the property or meets the borrower. If the insurer takes title, the insurer works to sell the property as quickly as possible. Mortgage insurers do not hold property for long periods of time.

Mortgage insurers generally take title to the property in the following circumstance: when a borrower defaults on his mortgage, the lender begins foreclosure proceedings. In the vast majority of instances, when the lender has received marketable title to the property he submits a claim to the insurer. At that point, the mortgage insurer pays the claim and may take title to the property.

In a very few cases, the mortgage insurer may step in prior to the lender completing the foreclosure process. In these situations, the mortgage insurer would institute the foreclosure proceeding. It is rare for a mortgage insurer to do this because the mortgage insurer can only pay a claim after a property goes through foreclosure. Many borrowers ultimately "cure" a loan after it has been 30, 60, or even 90 days in default or even during foreclosure proceedings. Therefore, the mortgage insurer generally does not acquire an interest in the property until foreclosure has been finalized. In addition, the various state laws which regulate the industry require that all claims be paid in such a way that any loss to the insurer is mitigated. Since the expenses associated with the foreclosure process generally make taking title prior to foreclosure the more costly alternative for the mortgage insurer, mortgage insurers rarely exercise this option in order to comply with state law.

Suggested Amendment to S.65:

If S.651 is not amended to include mortgage insurers, the industry could be exposed to unlimited liability for Superfund clean up. The industry's role of shifting some of the risk from the lender to the insurer enables lenders to serve borrowers with less money down. However, without adequate protection from liability for hazardous waste cleanup, mortgage insurers will be unable to participate in transactions on properties near or adjacent to hazardous materials, or questionable areas. This could severely affect moderate-income and first time homebuyers who find it difficult to accumulate a 20 percent downpayment and, therefore, rely on mortgage insurance.

In order to adequately protect the mortgage insurance industry, MICA respectfully submits the following language to amend S.651:

Add to Section 152, new Section 36 (h)(2)

> The term 'mortgage lender' also includes any person or governmental entity that insures or guarantees an extension of credit by a mortgage lender otherwise covered by this section against default in payment.

This language would assure that mortgage insurers are treated equally with lenders under Superfund and would protect the thousands of families who depend on mortgage insurance to purchase homes.

American Association
of Equipment Lessors

June 21, 1991

HAND DELIVERED

Senator Jake Garn
Ranking Minority Member
Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S.651, 102d Cong., 1st Sess. (1991)

Dear Senator Garn:

I'm writing to you on behalf of the American Association of Equipment Lessors (AAEL). We support legislation that encourages capital investment by clearly marking the limits of potential liability for banks and other financing sources under the various federal and state environmental laws.

Your bill, S.651, would insulate certain "mortgage lenders" and "insured depository institutions" (including affiliated leasing companies) from environmental liability

> under any Federal law imposing strict liability for the release or threatened release of a hazardous substance at or from property--
>
> (A) acquired through foreclosure;
> (B) held in a fiduciary capacity;
> (C) held by a lessor pursuant to the terms of an extension of credit [, which includes "lease transactions that are functionally equivalent to a secured loan and that are authorized by and comply with regulations issued by the appropriate Federal banking agency or State banking authority"] [S.651 at page 28]; or
> (D) subject to financial control or financial oversight pursuant to the terms of an extension of credit, [S.651 at page 19]

Overruling the opinion in United States v. Fleet Factors Corp., 90F.2d 1550 (11th Cir. 1990), cert. denied, ___ U.S. ___ (1991), S. 651 specifically provides (at p.20) that liability can not be based "solely on the fact that the institution or lender has the unexercised capacity to influence operations at or on property in which it has a security interest." The immunity would disappear if the otherwise immune entity (1) caused or contributed to the release of a hazardous substance; or (2) "following the acquisition of property through foreclosure or the termination of a lease agreement, failed to take reasonable steps to prevent the continued release of a hazardous substance * * * if such release is discovered * * * prior

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to or after that acquisition or termination of the lease"; or (3) "actively directs or conducts operations that result in the release of a hazardous substance". S.651 also provides that an otherwise immune entity would be liable to the extent that it received any "actual benefit" from a waste cleanup action.

Our basic submission is that, while your bill gives some protection to bank-affiliated leasing companies, it does not cover the majority of lease financing activities that should be protected from inappropriate strict liability under federal environmental laws. The objectives of S.651, sound policy, and basic fairness, would be better served under a bill recognizing that all leasing companies (both bank-affiliated and non-bank-affiliated) should receive the same scope of immunity from environmental liability when they engage in essentially identical lease financing activity. We describe below in part I (A) the important role that equipment leasing plays in assisting capital formation in this country, and (B) the uncertainties that now exist about a finance lessor's potential liability under federal environmental laws. In part II we urge modifying S.651 to accord equal treatment to both bank-affiliated and non-bank-affiliated finance lessors, and to make the protections in the bill more effective for all passive lease financing arrangements.

I. BACKGROUND

A. Equipment leasing in America. The volume of equipment leasing in this country is now over $130 billion a year, representing well over 30% of all capital investment in the United States each year. Second only to the commercial paper/-bond market, leasing is the second largest source of investment capital for business, industry and agriculture in our Nation's economy. AAEL is the major national trade association in this multi-billion dollar industry, with approximately one thousand member companies engaged in every conceivable aspect of equipment leasing.

Equipment leasing is commonly utilized, at least in part, by virtually every segment of our National economy. Types of equipment leased include computers, office equipment, manufacturing and industrial equipment, as well as transportation equipment. Facilities leasing is also becoming more common today, with tax incentives encouraging lessors to provide the financing and investment capital needed to build special types of facilities -- such as wastewater treatment plants, and facilities that generate electricity from municipal solid waste or used tires-- that are operated by others for essentially public purposes. Equipment leasing is one of the major options for American businesses to obtain needed capital equipment.

The importance of equipment leasing for improving our environment deserves special note. New leased equipment often helps minimize or prevent the creation of hazardous waste in the first place. Other lease financings create and support environmentally beneficial projects such as wastewater treament plants, facilities to generate electricity from municipal wastes, pollution control equipment, and waste clean-up equipment itself.

B. *The current "chilling effect" of strict liability environmental laws on lease financing*. Today the strict liability standards, in a wide variety of federal and state environmental laws, are exerting a "chilling effect" on lease financing, to the detriment of our economy generally, and to the injury of small business and environmentally beneficial projects specifically. Whenever a lessee/borrower's business involves even the slightest risk of environmental liability, financing (including lease financing) for new capital acquisitions and equipment is more costly or unavailable for that lessee/borrower.

"Owner or operator" strict liability is a feature of several federal environmental laws. *See*, *e.g.*, Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§6924, 6925; Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or "Superfund"), 42 U.S.C. §9601 *et seq*. The majority of the States and certain local governments have adopted similar environmental liability laws imposing strict liability for waste cleanup costs on "owners or operators". There appear to be no court opinions discussing the potential liability of equipment lessors under these environmental laws. Yet the reported cases do show that lease financing transactions have been broken up specifically because of the fear of CERCLA liability. *See Ogden Martin Systems of Tulsa, Inc.* v. *Tri-Continental Leasing Corp*., 734 F.Supp. 1057 (S.D.N.Y. 1990). Other cases show that equipment lessors have been named as defendants in CERCLA damage suits. *See Voluntary Purchasing Groups, Inc.* v. *Reilly*, 889 F.2d 1380 (5th Cir. 1989). And the U.S. Environmental Protection Agency's (EPA's) recently-announced proposed regulation of June 5, 1991 on "lender liability under CERCLA" seems to interpret CERCLA's "secured creditor exemption", in 42 U.S.C. 9601(20)(A), in a way that makes owner/lessors in lease financing arrangements subject to strict liability as "owners" under CERCLA.

Given this regulatory climate, the threat of CERCLA liability is an important reality that lease financers must consider before committing funds to a transaction. Hazardous waste cleanups often cost millions of dollars, which may be more than the value of the financing or the property itself, and CERCLA contains no limit on the amount of liability. Traditionally, finance lessors are not in a position to monitor the activities of the businesses which they finance, since they play no role in the management or operation of these businesses and also do not have staff with expertise in managing environmental matters. Moreover, if finance lessors were to try to increase their participation in management, they might well expose themselves to potential Superfund liability as "operators" of the financed business. See United States v. Fleet Factors Corp., supra. Faced with this dilemma, many finance lessors have stopped extending financing to businesses where there is even the smallest risk of hazardous waste contamination.[1] Other lenders and finance lessors have continued to extend financing in some but not all cases, but only at a premium price that reflects the risks and uncertainties of Superfund liability.[2]

Our informal AAEL surveys, conducted in recent months and attached to this letter as Attachments "A" and "B", confirm that, whenever a lessee/borrower's business involves even the slightest risk of environmental liability, lease financing for new capital acquisitions and equipment is more costly or unavailable for that lessee/borrower.

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[1] This has dried up financing for many worthwhile projects-- including wastewater treatment plants, cogeneration facilies, and small business projects such as gasoline service stations, print shops, cleaning shops, and farm equipment-- where there is even the smallest risk of environmental liability. The impact is particularly harsh on small business. According to a recent poll by the American Bankers Association (ABA), canvassing those banks who have assets of $250 million or less, "43 percent of respondents have already stopped making loans altogether to certain types of small businesses, those that [are] most frequently associated with environmental problems, and another 11 percent plan to do so shortly." Hearings before Senate Banking Committee on S.2827, Tr.65-66 (statement of Charles M. Mitschow) (July 19, 1990).

[2] Another "chilling effect" on financing stems from court decisions interpreting CERCLA to mean that a secured lender or lessor that forecloses on a facility that turns out to be contaminated with hazardous waste can be held liable for the entire cost of the cleanup plus damages, even if the lender or lessor in no way contributed to the hazardous waste problem at the facility. See, e.g., Guidice v. BFG Electroplating and Mfg.Co., 732 F.Supp.556 (W.D.Pa. 1989). See also United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990), cert. denied, ___ U.S.___ (1991). The so-called "innocent landowner" defense to Superfund liability applies most clearly to real estate (not personal property), and it requires an expensive environmental assessment before it can be invoked. See 42 U.S.C. §9601(35)(A)-(B), §9607(b)(3). The cost of an environmental assessment, which can range from $2,000 to well over $100,000, raises the cost of financing to effectively foreclose financing for many small businesses and other projects.

II. CONGRESS SHOULD EXPAND THE PROTECTIONS IN S.651 FOR PASSIVE LEASE FINANCING ARRANGEMENTS

Your bill, S.651, addresses these problems by protecting "mortage lenders" and "insured depository institutions" (including affiliated leasing companies) from liability under Federal environmental laws when they hold, control, manage or foreclose on property that turns out to be contaminated. This is entirely appropriate. These institutions are sources of financing; they do not cause or contribute to the release of hazardous substances into the environment. Imposing environmental strict liability on them would only undercut capital formation and the flow of capital for many environmentally beneficial projects.

A. Finance lease arrangements. The immunity of S.651 is appropriately extended to "finance lease" arrangements in which the lessor acts essentially as a source of financing. A finance lease is simply a way of financing the acquisition of new equipment. In a finance lease, the lessor essentially provides only money. It has nothing to do with managing or operating the equipment. In a finance lease the equipment is selected, operated and maintained by the finance lessee (the party who uses it), not the finance lessor.

Traditional tort law principles have long immunized finance lessors from strict tort liability because of their lack of involvement with the leased equipment. See Fraser, Application of Strict Tort Liability to the Leasing Industry: A Closer Look, 34 Bus.Law. 605 (1979). Similarly, the Uniform Commercial Code (UCC) immunizes finance lessors from warranty liability (warranties of fitness, merchantability, and the like) because of the finance lessor's lack of involvement with the leased equipment. See UCC §2A-407, §2A-103(1)(g). As Congress recently recognized in the Price-Anderson Act, there is no sound policy reason to impose "ownership" liability on finance lessors who do not possess or control a leased facility. See 42 U.S.C. §2210r, 102 Stat.1078. The original intent of Congress, in enacting the "secured creditor exemption" in CERCLA, 42 U.S.C. 9601(20)(A), was similarly to immunize these sorts of lease financing transactions from strict CERCLA liability.[3]

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[3] The origin of the "secured creditor exemption" in CERCLA was H.R. 85, 96th Cong., 1st Sess. (1979), as introduced Representative Biaggi in January 1979. The House Committee report accompanying that bill explained that the term "owner"

To some extent, S.651 reflects these principles. It accords immunity to some (but not all) finance lease transactions. Compare S.651, 102d Cong., 1st Sess. (1991) at pp.19, 28 (limiting liability of bank-affiliated leasing companies in "lease transactions that are functionally equivalent to a secured loan and that are authorized by and comply with regulations issued by the appropriate Federal banking agency or State banking agency") with 56 Fed.Reg. 28314 (June 20, 1991) (Comptroller of the Currency's final rule defining "lease financing transactions" authorized for national banks). But S.651 is cast too narrowly. There are compelling reasons to expand the scope of the lease financing arrangements protected under the bill.

B. Equal treatment of bank-related and non-bank-related lessors. Our central point is that all finance lessors, whether bank affiliated or not, should be shielded from inappropriate environmental liability. Your bill does not provide any protection for non-bank related leasing companies that engage in lease financing activity identical to the bank leasing activity that is protected under S.651. There is no good reason in public policy, however, why environmental law should distinguish between bank-affiliated lessors and non-bank-affiliated lessors engaged in identical transactions.

Today the equipment leasing industry accounts for well over 30% of all capital investment in the United States each

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> does not include certain persons possessing indicia of owership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws, rules, or regulations.
>
> Owners form one of the three major classes (the others being operators and guarantors) subject to liability under the Act. For example, a financial institution which held title primarily to secure a loan but also received tax benefits as the result of holding title would not be an "owner" as long as it did not participate in the management or operation of the vessel or facility.

H.R.Rept.96-172, Part 1, 96th Cong., 1st Sess. at 36 (May 15, 1979) (House Committee on Merchant Marine & Fisheries) reprinted in 5 1980 U.S.Code, Cong.& Admin. News 6181 (emphasis added).

year, placing over $130 billion worth of equipment in service annually in the United States. Non-bank related leasing companies provide about 70% of this lease financing, while 30% is provided by bank leasing companies. Moreover, non-bank leasing companies provide lease financing services that are essentially identical to those of bank leasing companies. Given these facts, it should be apparent that the purposes and intended economic benefits of S.651 would be better achieved if the legislation made no distinction between the environmental law liability of bank leasing companies and that of non-bank leasing companies engaged in essentially the same lease financing activity. To make this sort of distinction would distort the marketplace, creating different risks of environmental liability, with resulting differences in pricing and documentation, for different kinds of leasing companies all of which are engaged in the same identical economic activity. There is no justification for this result.

Moreover, the omission of non-bank leasing companies from environmental immunity under the current bill conflicts with the purpose of the legislation to insulate federally insured banking institutions from overwhelming environmental liabilities. This is because non-bank leasing companies commonly obtain their funding from federally-insured banks. The imposition of ruinous environmental liability on non-bank leasing companies, and their potential insolvency, would have an immediate impact on the financial health of federally insured banks.

The only sound public policy is to accord equal treatment under environmental law to both bank-related and non-bank-related lessors.

C. Scope of protected "lease transactions". When a finance lessor is simply acting as a source of financing, and does not cause a spill of hazardous substances, and has no involvement with the operation or maintenance of a facility involved in a chemical spill, the finance lessor should be immune from strict liability under environmental law. Your bill, on the other hand, limits immunity to lease transactions that are "functionally equivalent to a secured loan". This does not cover the full scope of common lease finance activities-- by both bank leasing companies and non-bank leasing companies-- where the lessor acts as a financing source, without operating the property or equipment or causing or contributing to any release of chemicals or other hazardous materials causing environmental damage. See, e.g., 56 Fed.Reg. 28314 (June 20, 1991) (Comptroller of the Currency's final rule broadening scope of "lease financing transactions" that are authorized for national banks).

Financial activity without involvement in management or operation should be the touchstone of immunity. There is no good reason in policy to adopt the restrictive "functionally equivalent to a secured loan" test now in S.651 (p.28).[4]

D. Equal treatment of secured loans and finance leasing. There is no good reason in environmental policy, or economic/capital formation policy, for environmental law to favor one type of financing (secured loans) over another competing form of financing (lease financing). We submit that S.651 should treat lease financers just like secured creditors in their ability to provide financing.

Ordinary secured lenders under current law are not "guarantors" or "deep pockets of last resort" who are inescapably liable for the costs of cleaning-up environmental damage caused by their borrowers. Under existing principles of law, it is reasonably clear that lenders which do not hold title as "owners" of property may merely "hold" their security interest and, instead of foreclosing in the event of default, may simply abandon the collateral without incurring environmental liability for the acts of the debtor. What is not clear under existing law, however, is whether the same principles of law would apply to a financer who technically holds title to the collateral as in many lease financing transactions. Therefore, we recommend that the bill be modified to allow a lease financer to merely hold its interest or to abandon the collateral without thereby becoming liable.[5]

Today finance leasing plays a vital role in our Nation's economy. To safeguard this important source of investment, and to keep a "level playing field" for the choice between different kinds of financing (secured lending vs. leasing) to acquire capital equipment, the same environmental immunity should be extended to companies engaged in lease financing, on the one hand, as is extended to companies engaged in secured lending, on the other hand. The legislation should not treat passive lease financers (any more than secured lenders) as deep pocket "guarantors" of the environmental soundness of facilities selected, operated and maintained by the borrower/lessee.

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[4] Moreover, S.651 is not as clear as it might be that its limited environmental immunity applies in cases involving personal property and equipment, as well as in cases involving real property.

[5] EPA's recently-announced proposed rule on "lender liability under CERCLA" would provide continuing immunity to financers after foreclosure, essentially so long as they make continuing efforts to sell the collateral. The same immunity after foreclosure should be extended to lease financers.

The impact of our proposals would put all finance lessors and secured lenders on an equal footing, and would accord them limited immunity from strict environmental law liability, in accordance with the principles in S.651. We also believe that our proposal fairly implements the original intent of the "secured creditor exemption" in the federal Superfund statute (42 U.S.C. §9601(20)(A)). See n.3.

Thank you for considering AAEL's views on this important issue. Our industry is concerned about the "chilling effect" that strict liability environmental laws are now having on finance leasing. We look forward to your earliest favorable response.

Yours very truly,

Michael Fleming

Michael J. Fleming
President, AAEL

cc: Members of the Senate Committee
on Banking, Housing, and Urban Affairs

Statement of the Federal Home Loan Mortgage Corporation
on
The Federal Deposit Insurance Improvement Act of 1991 (S. 651)
Senate Banking Committee
June 12, 1991

The Federal Home Loan Mortgage Corporation (Freddie Mac) is pleased to offer its perspective on the mortgage finance implications of lender liability provisions in the "Federal Deposit Insurance Improvement Act of 1991" (S. 651), introduced by Senator Garn. S. 651 responds to several Federal Courts decisions which construed provisions of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) to hold mortgage lenders liable for clean-up costs of hazardous waste sites acquired by the lenders through the foreclosure process. We support S. 651 because it recognizes the unique role of mortgage lenders as innocent holders of mortgage assets.

The 1990 Federal Appellate Court decision, United States v. Fleet Factors Corp., (901 F.2d 1550, 11 Cir. 1990) ruled that if a lender had the capacity to influence a borrower business, it could be required to bear the costs of cleaning up contaminated property even if it did not exercise its influence and had no actual knowledge or role in the creation of the contamination, or management responsibility over the property. This ruling has the very real potential of placing great burdens on the lending community, which will ultimately lead to increased costs to the borrowing public. It could also lead to greater reluctance among lenders to provide financing for the housing industry in particular.

The secondary mortgage market provides a reliable source of funds for mortgage credit at the lowest possible cost and has been the major stabilizing influence in residential finance. Risk-based capital rules, mandated by FIRREA, have prompted lenders to significantly rechannel mortgage assets to securitization; thus Freddie Mac's role has become even more important.

The role of this steady supply of funds was reinforced by Alan Greenspan, who credited the secondary mortgage market with preventing a credit crunch similar to the one recently affecting commercial real estate lending. Freddie Mac has been able to supply home credit needs throughout the nation by relying on a combination of delegated underwriting (which makes lenders responsible for originating, underwriting and servicing loans), contractual warranties and lender monitoring.

In most cases, when Freddie Mac purchases mortgages from primary lenders, we hold the mortgages but exercise no management or control over the properties. In fact, because we purchase loans on a wholesale basis from the primary lenders who underwrite and service those loans, we must rely on the primary lender's inspections of the properties for all information concerning the property. Further, our contracts with mortgage sellers require that lenders bring to our attention any environmental condition affecting the property.

In response to the environmental concerns, Freddie Mac has been working on industry standards for due diligence to identify possible environmental hazards. We endorse the need to provide homeowners with safe, affordable housing as well as the need to protect lenders and other participants in the lending process from unwarranted liability for cleaning up hazardous conditions they did not create.

We believe S. 651 takes a desirable step toward protecting innocent lenders, insured institutions and the government from exposure to open-ended environmental liability. Freddie Mac strongly supports the passage of S. 651, which would provide that innocent holders of mortgages would not unintentionally find themselves liable for clean-up costs. This provision will help ensure the continued supply of affordable mortgage credit to America's home buyers.

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June 19, 1991

WRITER'S DIRECT DIAL
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Lory Breneman
Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510-6075

Dear Ms. Breneman:

On behalf of my client, **Massachusetts Mutual**, I would like to submit the Statement for the record of MassMutual to the Senate Committee on Banking, Housing, and Urban Affairs for the hearings you held on June 4 on the issue of Superfund Lender Liability. As per your rules, I am attaching two copies.

If you have any additional questions, please let me know. We look forward to inclusion of this material in the record.

Sincerely,

John F. Jonas

JFJ/alo

Enclosures

STATEMENT OF
MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY
TO THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE
HEARINGS ON
SUPERFUND LENDER LIABILITY

JUNE 12, 1991

Massachusetts Mutual Life Insurance Company ("MassMutual") based in Springfield, Massachusetts, is the nation's 11th largest life insurance company. MassMutual is engaged in the sale of a complete portfolio of life and health insurance, individual investments, health and employee benefits and investment management. MassMutual serves more than one million individual and group policyholders and presently has assets in excess of $25 billion. MassMutual in conducting its business is involved in a full range of investment activities and, as of December 31, 1990, had approximately $10.5 billion invested in commercial mortgage loans and private placements to support its obligations to its policyholders.

Massachusetts Mutual Life Insurance Company ("MassMutual") would like to express its appreciation to Chairman Riegle and the Committee for this opportunity to express MassMutual's views on and support for legislation addressing the issue of lender liability under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") with particular reference to H.R. 1450 offered in the House by Representative LaFalce and recent case law interpreting CERCLA and requests that this statement be made a part of the official record of the hearing. Recent judicial interpretations of CERCLA pose a grave threat to the thousands of financial institutions including life insurance companies who provide commercial loans and credit to the nation's borrowers and, accordingly, to the national credit markets.

MassMutual strongly supports the goals of CERCLA and other environmental laws in seeking to protect and preserve the nation's health, environment and natural resources from pollution and hazardous substance contamination. The clean-up of existing contamination and the prevention of future contamination are important public goals of our nation.

MassMutual is concerned, however, as are all financial institutions who are engaged in commercial lending, with the decision of the Eleventh Circuit in U.S. v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990) ("Fleet"). The Fleet decision, in effect, can render a lender strictly liable for the cost of environmental cleanup in situations in which it is without fault and has simply reserved certain traditional rights under its loan documents to administer its loan in a prudent manner. Such rights are generally accepted as necessary to allow lenders to protect their loans including the collateral for those loans and to insure the safe keeping and repayment of the funds of its depositors, policyholders or shareholders, as the case may be, which have been loaned.

A subsequent decision of the Ninth Circuit Court of Appeals in In re Bergsoe Metal Corporation, 910 F.2d 668 (9th Cir. 1990) ("Bergsoe") has added to the uncertainty engendered by Fleet. In addressing the issue of secured creditor liability under CERCLA, the Court stated that there "must be some actual management of the facility" before a creditor may be liable. The Court chose, however, "not to engage in line drawing" and did not define what it meant by "actual management". Thus, even if Bergsoe represents a weakening of Fleet by requiring some form of actual management as a precondition to liability, it still leaves lenders in a state of uncertainty as to what will cause them to incur CERCLA liability. Moreover, even assuming that Bergsoe repudiates Fleet, the Bergsoe decision is the law of the Ninth Circuit only and is not binding on the other federal District and Circuit courts. With the Supreme Court's recent denial of certiorari in the Fleet case, this uncertainty will continue.

We do not believe that Congress in enacting CERCLA intended the result reached in the Fleet decision. In light of the current problems in the banking and savings and loan industries, it also seems particularly inappropriate to penalize commercial lenders for exercising prudence in their lending practices. Consider also if you will that a relatively small commercial loan under the Fleet decision can lead to liabilities for a lender far in excess of the original investment. The costs of environmental clean-ups are very expensive and can be open ended. When such risk exists with respect to each loan in a lender's portfolio, the economic viability of those lenders is placed seriously at risk.

Lenders who are not at fault in any way, who have reserved certain rights in their loan documents to assure the proper administration of a loan and who have administered their loans prudently and in a manner designed to protect their policyholders, depositors or shareholders should not have to risk incurring liabilities which may far exceed their original investment and, in turn, jeopardize their financial stability and health solely because they have engaged in the socially and economically desirable activity of making loans and credit available to borrowers.

MassMutual does not propose that lenders should be free from responsibility in its lending practices. Certainly, lenders should be encouraged to conduct appropriate environmental due diligence prior to making loans. MassMutual as a lender and investor has for several years applied environmental due diligence procedures in its commercial mortgage lending and real estate investment activities.

Additionally, MassMutual along with other parties including other life insurance companies is participating in a process intended to develop generally accepted standards of environmental due diligence in connection with lending and purchase transactions. This effort is being sponsored by the American Society of Testing and Materials ("ASTM"). We believe that this process will yield a set of standards which will bring certainty as to what is required of a lender or a purchaser to be reasonably comfortable that a site is not contaminated and, similarly, to allow a purchaser to qualify as an "innocent purchaser" under the Superfund Amendments and Reauthorization Act ("SARA").

The Congress should be aware, however, that there also exist billions of dollars of commercial loans which were closed prior to the passage of CERCLA and for which environmental due diligence was not a requirement at the time. Any bill which conditions protection from liability on the performance of proper environmental due diligence at the time of the closing of the loan must also take into account these pre-CERCLA loans.

Recent judicial interpretations of CERCLA such as the Fleet decision not only place the solvency of financial institutions including life insurers at risk but also jeopardize the availability of credit in general. Should lenders in response to such developments either increase the cost of borrowing (interest rates) to compensate for the increased risk of strict liability under CERCLA or limit the availability of credit generally, there would be a devastating impact upon our nation's economy. problems in the banking industry and the savings and loan crisis have already caused a significant tightening of the availability of credit. A further retrenchment in lending would surely exacerbate the current recession. It should also be noted that the American taxpayer could ultimately be called upon to bear the cost of environmental clean-up imposed on a failed thrift institution which has a CERCLA liability as a result of the theory espoused in the Fleet decision.

The Fleet Factors Decision

CERCLA provides that a secured creditor who, "without participating in the management of a...facility, holds indicia of ownership primarily to protect his or her security interest in a facility" is exempt from liability under CERCLA.

While this statutory exemption from liability appears on its face to protect lenders, the courts have issued conflicting rulings and have been quite aggressive in finding lenders liable under CERCLA.

In U.S. v. Mirabile, 15 Evntl. L.Rep. 20992 (E.D. Pa., 1985), it was held that the secured lender exemption protects a lender in its capacity as an owner following foreclosure. The court also held, however, that a lender who participates in the day to day operations of the borrower's site can incur CERCLA liability as an operator. Contrary to the holding in the *Mirabile* case, the court in *U.S. v. Maryland Bank and Trust*, 623 F.Supp. 573 (D. Md. 1986), held that the secured creditor exemption does not apply to a lender who has foreclosed a mortgage or deed of trust and that the CERCLA exemption only protects lenders in their capacity as lenders.

Not only did the *Mirabile* and *Maryland Bank* cases create uncertainty as to whether or not a foreclosing lender is protected under the secured lender exemption, but they created a good deal of uncertainty among lenders as to what level of involvement in the day to day operations of a site would create lender liability. It was generally believed, however, that, if a lender did not involve itself in the day to day operations of a borrower's site, it could safely involve itself in the financial affairs of the borrower.

The holding of the Eleventh Circuit in *Fleet* represents a significant departure from prior case law and greatly expands the risk of liability for lenders. The *Fleet* decision can be read to hold that a lender is liable for cleanup costs under CERCLA if it participates "in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste." In other words, it is not necessary for a lender to be involved in the day to day operations of a site to be found liable. Rather, it is sufficient for liability to attach for the lender simply to have the capacity to influence hazardous waste decisions of its borrower. This capacity could be found if a lender simply has the right under its loan documents to exercise certain controls over the borrower's financial activities and the loan collateral which controls are in keeping with traditional and prudent lending practices.

In all lending transactions, the lender imposes certain financial covenants and restrictions to insure that the borrower continues to operate its business in a prudent manner. Commercial real estate lending transactions, for example, typically require the borrower to obtain the lender's approval of new leases, to changes in ownership and management and to the placing of secondary financing on the property. Covenants and restrictions of this type under the *Fleet* decision could well bring the lender within the scope of CERCLA liability.

Additional Adverse Effects of Fleet Factors

In response to *Fleet*, lenders have three choices in attempting to lessen their exposure. They may lower the risk of liability by significantly curtailing their lending activities, they may eliminate from their loan agreements the financial covenants and protections which are fundamental to the continued success of a loan but which would cause them to run afoul of the *Fleet* decision, or they may simply ignore the risk. Any one of the choices involves serious adverse consequences for the lender and the economy.

Rights such as the right to approve leasing, ownership, management and the further encumbering of the security insure that the project will remain viable and that the lender's loan will be successfully repaid. The elimination of such provisions significantly increases the risk that the loan will not perform successfully. Should lenders seek to protect themselves by eliminating such covenants from their loan documents, therefore, they would be jeopardizing the quality of their loan portfolios and most likely incur substantial criticism from regulators, shareholders, depositors and policyholders.

In Fleet the Eleventh Circuit has taken the approach that, if lenders are aware of their potential liability, they will be encouraged to monitor the activities of their borrowers. The Court stated:

> Creditor's awareness that they are potentially liable under CERCLA will encourage them to monitor the hazardous waste treatment systems and policies of their debtors and insist upon compliance with acceptable treatment standards as a prerequisite to continued and future financial support.

While it is certainly a worthy goal to have lenders monitor the activities of their borrower's to assure compliance with laws, the Fleet holding encourages the very response its seeks to avoid. Lenders attempting to tiptoe along the line of liability may conclude that they are better served by stepping away from an environmental problem and take a "hands-off" approach in order to minimize their involvement in the affairs of the borrower. Only if lenders may encourage borrowers to comply with environmental laws without the lender itself fearing liability will the public policy goals expressed in the Fleet decision be achieved.

Another detrimental affect of the Fleet decision is that loan workouts are discouraged. Workout agreements typically impose certain financial restrictions on a borrower. As noted above, however, a lender cannot impose such restrictions without increasing its risk of liability under CERCLA. Lenders will, therefore, be less inclined to enter into such agreements with borrowers, resulting in a higher number of foreclosures.

In short, without legislative preemption, the Fleet decision will have a significant adverse effect upon financial institutions, borrowers, the environment, credit markets and the economy.

H.R. 1450

In view of the foregoing considerations, MassMutual thanks the Subcommittee for conducting the proceedings today and applauds Representative LaFalce for offering H.R. 1450.

MassMutual strongly supports H.R. 1450 and its reversal of Fleet. The bill reverses Fleet by providing that a lender will be subject to liability only if its involvement with a facility is "actual, direct, and continual or recurrent". In doing so, the bill insures that lenders will be able to administer their loans in accordance with prudent business practice without fear that they will incur liability and without fear that they are placing the solvency of their respective institutions in jeopardy. The bill also removes a significant impediment to workout arrangements by providing that a lender may take action to "preserve and protect" its security. This language allows a lender to enter into workout arrangements without concern that it may cause cross the line of liability.

The bill also encourages lenders to conduct environmental due diligence for it provides that completion of an environmental inspection or audit is "probative evidence" that the lender acted consistently with the secured lender exception. While the bill does not require lenders to conduct a pre-closing environmental audit, because a large percentage of the loan portfolios of lenders are made up of loans which predate CERCLA and, hence, predate the emergence of the environmental audit, a bill which provided protection from liability only to those transactions which were the subject of an environmental audit would unfairly expose a significant portion of a lender's portfolio to liability. By encouraging rather than requiring pre-closing environmental audits, the bill balances the need to protect a lender's entire loan portfolio with the goal of encouraging pre-closing audits.

In not mandating environmental audits, the bill also recognizes that it is in the lender's best interest to conduct a pre-closing audit. Lenders lend money to obtain a return on their investment and, as is often the case with insurance companies, to obtain an investment yield which will allow them to meet their obligations. If the payments on the loan are interrupted because an environmental problem has impaired leasing efforts and depleted the borrower's resources, the lender must reach into its general funds to honor its obligations. It is in the lender's best interest, therefore, to conduct a pre-closing audit and to avoid becoming involved in those properties which are or may become contaminated.

At a hearing on the predecessor to H.R. 1450, H.R. 4494, an official of the Environmental Protection Agency ("EPA") testified that EPA intended to promulgate rules to address the issue of lender CERCLA liability. While EPA has informally circulated proposed rules, as Representative LaFalce has noted in a statement attached to H.R. 1450, "legislation is necessary to give statutory guidance, to address a few items omitted by EPA, and to give certainty to EPA's efforts".

Once again, MassMutual thanks Chairman Riegle and the Committee for the opportunity to submit this statement, which we request be made a part of the official record of the hearing. We also urge the Subcommittee to support and to encourage support of a Senate bill which mirrors H.R. 1450.

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July 19, 1991

BY HAND

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510-6075

Attention: Laurie Breneman

Dear Chairman Riegle:

The Bank Lessors Group is an *ad hoc* group of bank affiliated leasing companies that was formed to monitor legislative and regulatory developments affecting leasing activities of federally regulated banking organizations. Arnold & Porter serves as counsel to the Bank Lessors Group.

The Bank Lessors Group is pleased to submit the attached written testimony in support of legislation to clarify that bank leasing companies and other financial institutions are exempt from liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. The Bank Lessors Group commends the Senate Committee on Banking, Housing, and Urban Affairs for holding hearings on this important legislation and requests that the attached submission be included in the written hearing record.

Sincerely,

Melanie Fein
Melanie L. Fein

Enclosure

Testimony by

The Bank Lessors Group*

on the Potential Liability of Bank Leasing Companies under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980

Submitted to the
Committee on Banking, Housing, and Urban Affairs
United States Senate

July 19, 1991

Melanie L. Fein, Esq.
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Attorneys for the
Bank Lessors Group

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* The Bank Lessors Group includes leasing companies affiliated with the following banks: Bank of New York, Bank of Tokyo, Chase Manhattan Bank, N.A., Citibank, N.A., Continental Bank, N.A., First National Bank of Boston, First Security Bank of Utah, N.A., Mellon Bank, N.A., Pittsburgh National Bank, Security Pacific National Bank, The Tokai Bank, Limited, and U.S. National Bank of Oregon.

Testimony by the Bank Lessors Group

on the Potential Liability of Bank Leasing Companies under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980

Submitted to the
Committee on Banking, Housing, and Urban Affairs
United States Senate

July 19, 1991

The Bank Lessors Group is an ad hoc group of bank affiliated leasing companies that was formed to monitor legislative and regulatory developments affecting leasing activities of federally regulated banking organizations.

The Bank Lessors Group is pleased to have the opportunity to submit this written testimony in support of legislation to clarify that financial institutions, including bank leasing companies that engage in passive financing activities, are exempt from liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"). The Bank Lessors Group commends the Committee for holding hearings on this important issue.

The Committee has heard convincing evidence that bank lenders may be unwilling to provide financing to small businesses located in areas where a possibility of hazardous waste contamination exists or may be reluctant to lend to small businesses to finance industrial facilities due to potential CERCLA liability. For many of the same reasons, bank leasing companies are becoming unwilling or reluctant to provide lease financing to certain types of lessees or for certain types of property and equipment without clear CERCLA protection.

Lease financing has become a major substitute for commercial lending during the past twenty years and is an increasingly important part of the business of banking. Leasing accounts for almost one third of all capital investment in the United States each year. More new equipment is financed in the United States through leasing than through any other financing means except the bond market. In 1989, approximately $130 billion in new equipment was financed by leasing transactions. Bank leasing companies acted as lessors in approximately 30 percent of these transactions.

The threat of substantial and unpredictable liability under CERCLA not only inhibits bank leasing transactions with certain classes of customers but also poses increased risk of loss to the federal deposit insurance system. A bank leasing company that incurs major CERCLA clean-up costs may be forced to look to its parent bank or bank holding company for funds to pay the liability, thereby weakening the entire banking organization and increasing the potential liability to the federal deposit insurance fund. The amount of CERCLA costs imposed on a leasing company would not be limited by the company's size or the amount of the lease by which it acquired ownership of the contaminated property.

The legislative history of CERCLA indicates that Congress originally intended to provide an exemption from CERCLA liability for lease financing activities. The definition of "owner" was stated to exclude persons possessing indicia of ownership in connection with a leasing transaction:

> Owner . . . does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a . . . facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws. For example, a financial institution which held title primarily to secure a loan but also received tax benefits as a result of holding title would not be an "owner" as long as it did not participate in the management or operations of the . . . facility. (Emphasis added.)

1980 U.S. Code Cong. & Ad. News 6119, 6181-82, quoting from H. Rep. No. 96-172, 96th Cong., 2d Sess. 36-37 (1980).

Although the legislative history of CERCLA demonstrates that lease financing activities were intended to be exempt, recent court decisions and actions by the Environmental Protection Agency ("EPA") have raised considerable doubt as to whether such activities are protected in fact. Under some interpretations of the law, bank leasing companies may be exposed to significant potential liability under CERCLA as a result of holding title to property and equipment solely for the purpose of financing the acquisition and use of such property and equipment by third party lessees. Leasing companies have been identified by the EPA as potentially liable parties under CERCLA for environmental clean-up costs where the lessor apparently had no role in the operation, management, or supervision of the leased property or equipment. See Voluntary Purchasing Groups Inc. v. EPA, 889 F.2d 1380 (5th Cir. 1989).

Congress recognized the limited role that lessors play in financing equipment and other property when it exempted them from liability in connection with nuclear incidents in the Price Anderson Amendments Act of 1988. That Act provides that

> No person under a bona fide lease [of a nuclear facility] . . . shall be liable by reason of an interest as lessor . . . for any legal liability arising out of or resulting from a nuclear incident resulting from such facility unless such facility is in the actual possession and control of such person

> at the time of the nuclear
> incident . . . .

42 U.S.C. 2210. Just as Congress exempted leasing companies from liability under the Price Anderson Act, such companies should be exempt under CERCLA.

Lease financing is the functional equivalent of lending and is treated as such for purposes of the federal banking laws regulating bank lending activities. See 12 C.F.R. § 23.5; 12 U.S.C. §§ 84, 371c. In a typical lease financing, the customer will select specific property or equipment for use in its business operations. For tax and other business reasons, the customer may choose to acquire the property by leasing it rather than purchasing it. As a means of financing the acquisition of the property for lease, the customer will request a bank to purchase the property and lease the property to the customer. In other cases, the customer may wish to engage in a sale and lease back of existing assets in order to raise additional funds for working capital and will request bank lease financing.

In order to achieve the desired tax and other benefits of the transaction, the bank will hold title to the property but, during the term of the lease, as in a lending transaction, will not possess or have any other interest in the property other than as collateral. The lessee, rather than the bank, will operate, manage, maintain, possess, and insure the property as if it were the owner of the property. Indeed, under federal banking laws, bank leasing companies may not operate or manage leased property and are prohibited from providing any maintenance, servicing, or insurance of leased property during the lease term. *See* 12 C.F.R. § 23.2 and 12 C.F.R. § 225.25(b)(5).

Bank lessors typically will seek to protect the value of the collateral to which they hold title, as well as guard against CERCLA liability, by using the same precautionary testing, evaluation, representations and warranties, monitoring, and inspection requirements which may be required of a borrower by a lender. Nevertheless, there is no assurance to the lessor that contamination of equipment or a facility may not be overlooked or concealed.

Although leasing companies may be eligible in some circumstances for the "innocent landowner" exemption under CERCLA, that exemption has been very narrowly construed in the case law to date and does not apply to leases of personal, as opposed to real, property. Moreover, while a bank lessor certainly should be entitled to the "security interest" exemption under CERCLA because it holds title to leased property primarily to secure its interest in the property, the

EPA has argued strenuously for a very narrow reading of the "security interest" exemption.

Bank lessors would remain subject to potential CERCLA liability under EPA's recent draft rule. The proposed rule states that CERCLA's security interest exemption will apply only to "some forms of leases." EPA would decide the applicability of the exemption to leases on a case-by-case basis, depending on whether the transaction would create a security interest.

The preamble to the proposed rule suggests that the "applicable law" to which EPA is likely to look would normally be applicable state commercial law. A footnote refers to section 1-207(37) of the Uniform Commercial Code ("UCC"), which specifies when a leasing transaction creates a security interest. Under the UCC and the case law of most states, the types of "leases" held by courts to create a security interest typically contain some or all of the following provisions:

- at the end of the lease period, the lessee either is obligated to purchase the equipment or has the option to purchase the equipment at no or a nominal additional payment, or the lessee would have no sensible alternative other than to exercise an option to purchase at the expiration of the lease;
- rental payments made by the lessee are either counted toward the purchase of the equipment at the end of the lease or build up the lessee's equity in the equipment; and

- the combined sum of the rental payments would be roughly equivalent to the fair market value of the equipment at the time of the lease, plus a financing charge.

However, a true lease normally does not create a security interest of the type contemplated by the UCC. In a true lease, the lessee has no obligation to purchase the leased property at the end of the lease. Any option to purchase would be at the fair market value at the time of purchase, and rental payments normally are not counted toward the purchase of the equipment.[1] Thus, a true lease, where the leasing company expects to reacquire the leased equipment at the end of the lease, would appear to fall outside of EPA's proposed rule. Consequently, it will remain questionable whether a substantial portion of the transactions financed by leasing companies will qualify for the security interest exemption. Bank lessors will continue to be in the impossible position of facing potential CERCLA liability even though they, like other passive lenders, cannot exercise control over the leased property due to restrictions in the federal banking laws.

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[1] Among the numerous cases reaching these results are Lectro Management Inc. v. Freeman, Everett & Co., Inc., 373 A.2d 544 (Vt. 1977); Bonczek v. Pascoe Equipment Co., 450 A.2d 75 (Pa. Super. 1982); Brokers Leasing Corp. v. Standard Pipeline Coating Corp., 602 S.W.2d 278 (Tex. Civ. App. 1980); Citizens & Southern Equipment Leasing, Inc. v. Atlanta Federal Savings & Loan Ass'n, 243 S.E.2d 243 (Ga. App. 1978).

For the foregoing reasons, the Bank Lessors Group strongly supports legislation to provide a clear exemption from CERCLA for bank-affiliated companies that engage in passive lease financing activities.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM WILLIAM SEIDMAN

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

July 10, 1991

Dear Mr. Chairman:

Thank you for your questions following our June 12, 1991, testimony on environmental lender liability.

We are pleased to enclose responses to the questions. If you have any further questions, please let us know.

With best wishes.

Sincerely,

L. Wm Seidman

L. William Seidman
Chairman

Honorable Donald W. Riegle, Jr.
Chairman
United States Senate
Committee on Banking, Housing,
and Urban Affairs
Washington, D.C. 20510

Enclosure

QUESTIONS FOR CHAIRMAN SEIDMAN FROM SENATOR DONALD W. RIEGLE, JR. JUNE 12, 1991, HEARING ON LENDER LIABILITY

Q.1. Is it sufficient that legislation create "safe harbors" that clarify lender actions that do not expose lenders to environmental liability, or is it necessary to go further and limit lenders' losses in the event they incur liability?

A.1 There are merits to both approaches, one clarifying "safe harbor" activities and the other establishing limits on environmental liability. As we have stated previously, the FDIC and the RTC believe legislation is needed to ensure that lenders are not held liable for environmental contamination that they did not cause. If legislation that creates a so-called "safe harbor" clearly establishes that lenders will not be held liable for contamination they did not cause, it would not be necessary to limit lenders' losses in the event they incur liability. It is important, however, that any such "safe harbor" provision remove any uncertainty for lenders concerning the actions which would make them liable. At a minimum, any such "safe harbor" legislation should include a codification of the proposed EPA rule on lender liability.

It is noted that S. 651 does not provide any "safe harbors" from immunity, other than clarifying that an insured institution would not be liable for the unexercised capacity to influence operations at property in which it has a security interest. The bill provides an effective alternative, however, by limiting the environmental liability of insured depository institutions to fair market value for property acquired through foreclosure, held in a fiduciary capacity, or held pursuant to terms of an extension of credit. Understandably, this liability cap is lost if the lender caused or contributed to the release, or following foreclosure, failed to take reasonable steps to prevent the continued release of hazardous substances.

A liability cap may provide relief for "credit crunch" problems experienced by certain industries which involve hazardous substances, such as gas stations, printers, dry cleaners, pest control firms, and agribusiness. Irrespective of the size of a loan, a Superfund lawsuit could result in a claim that is far in excess of a lender's net worth. Without protection against unlimited liability, insured institutions may refuse to lend to certain affected industries. While a cap may be effective in reducing credit crunch problems, delineation of "safe harbor" activities may not have such effect. For this reason, Congress may wish to employ both approaches.

Q.2. How important is it to the FDIC and RTC that the liability of banks and thrifts acting in a fiduciary capacity be clarified?

A.2. The FDIC and the RTC are concerned about any situation that has the potential to adversely affect the financial position of an insured depository institution or have a negative impact on the deposit insurance fund. It is important that there is clarification of when a bank or thrift may be subject to environmental liability simply for acting in a fiduciary capacity.

Q.3. What changes in current law would you recommend to clarify the liability of banks and thrifts acting in a fiduciary capacity?

A.3 Under current law, a bank or thrift acting in a fiduciary capacity may be liable under CERCLA for environmental contamination that it did not cause. This liability attaches solely because the fiduciary is found to be the owner of the property and is not protected from CERCLA liability by the so-called secured creditor exemption. The FDIC and the RTC would support legislation that establishes that a bank or thrift acting in a fiduciary capacity is not liable for environmental contamination that it did not cause.

Q.4. If S. 651 were passed, who does FDIC/RTC expect would fund and manage the clean up of contaminated properties held by FDIC or RTC?

A.4 With regard to real estate owned ("REO") containing environmental hazards, it is our preferred approach to dispose of such assets by reducing the price commensurate with the cost of remediation, with the purchaser then effecting the remediation. As much as possible, it is our intention to sell properties "As Is," without any indemnities, and as quickly as possible. When appropriate, contingencies may be placed in sales contracts or funds may be placed in escrow to insure satisfactory completion of the remediation by the third party. However, to the extent that such third party transferees do not complete the remediation satisfactorily, it is possible that the EPA or analogous state agencies will ultimately fund and manage the clean up.

The FDIC and the RTC will pay for and manage actions taken in response to emergencies that pose a risk to public health and safety. The FDIC and the RTC themselves may also pay for and manage clean ups in other appropriate circumstances, such as where the clean up cost is clearly estimated to be less than the value of the property following clean up. However, it is not the intent of the FDIC and the RTC to routinely clean up contaminated property and it is not our intent to do so when it is anticipated that a large-scale remediation will be required. In this latter case, legislation should be passed to require the EPA or other agency with remediation expertise to fund and manage the clean up when so requested by the FDIC or the RTC.

Q.5. If the EPA, State EPA, or third parties (other than the first purchaser) fund and manage the clean up, is FDIC or RTC concerned with its lack of control over its costs of holding assets pending clean up?

A.5. The FDIC and the RTC prefer to sell their assets "As Is" as expeditiously as possible. Thus, ideally, we would not incur holding costs during the clean up, inasmuch as the asset would have passed into the possession of the purchaser. If legislation was enacted that permitted the FDIC/RTC to transfer properties to the EPA in instances where the property was so badly contaminated that a purchaser was not available and the property was transferred to the EPA, we would not incur out of pocket holding costs as those costs would be assumed by the EPA. We would be concerned, however, if the clean up was not immediately undertaken since there could be substantial opportunity costs resulting from a delay in selling the property.

Q.6. What are your views on legislation that would provide that, if a purchaser did not fund and undertake the clean up, the FDIC or RTC either could do so (1) pursuant to a clean up plan that received accelerated review and approval by the EPA and (2) subject to timely reimbursement from the Superfund, Leaking Underground Storage Tank Trust Fund, or other appropriate Federal fund and assignment of any contribution claim of FDIC/RTC against third parties to the appropriate Federal fund, or could abandon the asset to the appropriate Federal fund? (If the first purchaser undertook the clean up subject to indemnification by FDIC/RTC, the legislation could provide for reimbursement of FDIC/RTC by the appropriate Federal fund of the indemnity costs incurred pursuant to an EPA-approved clean up plan.)

A.6. The preference of the FDIC and the RTC is to sell the property "As Is" with the purchaser performing the clean up with the assurance of reimbursement from the appropriate Federal fund. In cases where the property cannot be sold until the clean up is completed, having the option to transfer the property to an agency for purposes of clean up and sale would be beneficial to the FDIC and the RTC. Under this option further holding costs would be eliminated and the clean up would be under the direction of an agency uniquely qualified to handle such a task. On the other hand, if the FDIC or the RTC were to exercise the other suggested option of undertaking the clean up directly subject to reimbursement by the EPA, they would face additional holding costs and administrative expenses during the clean up period. Therefore, this option would most likely be employed only as a last resort.

Q.7. You indicated in your June 12 testimony that the estimated average holding period for assets with real or potential hazardous substance liability is 32 months. How was this estimate arrived at?

A.7. The estimated average holding period of 32 months for assets with real or potential hazardous substance liability was based on a survey of each of the 238 assets identified as having hazardous substance issues. The holding period was estimated for each of the 238 assets taking into consideration the type of asset, the estimated degree of contamination, market conditions, and any other known factors that would affect the disposal of the property. An average of these individual holding periods was calculated to be 32 months.

Q.8 What types of assets held by the FDIC or RTC are most likely to be sold at a more favorable price by reason of the first purchaser immunity proposed in S. 651?

A.8 The FDIC and the RTC anticipate that the type of asset which will likely be sold at a more favorable price by reason of the first purchaser immunity proposed in S. 651 will be those assets which have definitive, quantifiable and low level clean up costs. In addition, the costs of remediation should be low when compared to the value of the property after the clean up is complete, with no long term monitoring required. Such assets are likely to be more marketable also if the buyer intends to use the property rather than hold it for investment purposes.

Q.9. What types of assets are least likely to be sold at a more favorable price by reason of such immunity?

A.9 If the immunity is only extended to the first purchaser, then those properties which have unknown, hard to quantify or very high clean up costs will be the ones least likely to be sold at a more favorable price, especially where longterm monitoring of remediation may be necessary or where the asset is being purchased for investment purposes. This inability to quantify the costs and time involved in cleaning up the property will probably make the risk too high for a potential buyer to assume, even with a first purchaser immunity.

Q.10. Do you think that the Federal banking agencies rather than the EPA should issue regulations that govern the environmental risk underwriting procedures of Federally-insured banks, thrifts, and credit unions?

A.10. The need for promulgating regulations that govern the environmental risk underwriting procedures of Federally-insured institutions has not yet been established. The banking industry is generally well versed in the risks and uncertainties under the current hazardous substance law. Lenders have attempted to control their environmental risks in a number of ways. Almost all large institutions address hazardous substance contamination and other environmental problems in their loan policies and/or procedures manuals. Smaller lenders usually deal with the environmental issues on an ad hoc basis, seeking outside advice when necessary. Before a credit decision is made, financial institutions often conduct environmental audits on potential loan customers that are involved in some way with hazardous substances. If the borrower is unable to repay the loan, many banks assess potential environmental risk before restructuring the loan or foreclosing on real estate held as collateral. Rigid underwriting regulations could potentially be dysfunctional by unnecessarily restricting options for dealing with complex environmental problems currently available to insured institutions.

If environmental underwriting regulations were deemed necessary, the FDIC agrees with the S. 651 provision which specifies that the Federal financial institutions regulatory agencies draft all regulations that impact insured institutions. The banking agencies have the responsibility to evaluate the strength of a depository institution's loan portfolio, the authority to promulgate the underwriting rules, and the ability to monitor compliance through our examination processes. The banking agencies would coordinate the drafting of any environmental underwriting regulations with the EPA.

Q.11. Should lenders have to comply with such environmental underwriting regulations in order to qualify for any "safe harbor" that legislation might provide for lenders?

A.11. No. Either the legislation affords the lenders protection or it does not. To link a salutary exemption to compliance with regulations is to expose a lender to liability for technical breaches of such regulation that have no substantive connection to alleged contamination.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
J. FRENCH HILL

DEPARTMENT OF THE TREASURY
WASHINGTON

July 25, 1991

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
  and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman:

By letter dated June 20, 1991, you requested the Department to provide answers to additional questions concerning the lender liability issue and S. 651, the "Federal Deposit Insurance Improvements Act of 1991." The Department's answers to those questions are enclosed.

Thank you for the opportunity to further address the lender liability issue. Please call me if we can be of any additional assistance.

Sincerely,

J. French Hill
Deputy Assistant
(Corporate Finance)

Enclosure

DEPARTMENT OF THE TREASURY

JUNE 12, 1991, HEARING ON LENDER LIABILITY

ANSWERS TO QUESTIONS OF SENATOR DONALD W. RIEGLE, JR.

Q1. I would appreciate your further elaboration of the views of the Treasury Department regarding legislation that would allow Federal financial regulatory agencies that act as liquidating receivers for private lenders to recover their losses first in the liquidation of failed lenders.

A1. While there could be benefits from nationwide depositor preference legislation, there would also be significant costs that would put our banks at a competitive disadvantage with foreign banks and nonbank financial institutions. In addition, the magnitude of the deposit insurance gains from depositor preference laws is uncertain because nondepositors can be expected to require collateralization that could fully offset the benefits to the insurer.

The FDIC's "pro rata" authority provided in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) permits a resolution method that retains most of the available benefits without imposing such high costs on nondeposit creditors.

For a more detailed discussion of this issue, attached is a copy of the section in the Department's recent study, Modernizing the Financial System, Recommendations for Safer, More Competitive Banks, which addresses depositor preference.

Q2. If S. 651 were passed, who does the Treasury Department expect would fund and manage the clean-up of contaminated properties held by the FDIC or RTC?

A2. Under proposed section 36(d)(3) of the Federal Deposit Insurance Act (FDIA), the immunity from liability granted to the FDIC and RTC by proposed FDIA section 36(d)(1) would extend to the first subsequent purchaser of property from the FDIC or RTC. Under this scheme, we expect that most clean-ups would be funded and managed by the first subsequent purchaser of the property, with the FDIC/RTC selling price of the property determined by market forces taking into account clean-up costs by the purchaser.

To ensure this result, we recommend, as stated in the Department's June 12 testimony, that immunity be conditioned on a commitment by the purchaser to clean-up the property consistent with the National Contingency Plan. Moreover, such immunity should not extend to any action by the purchaser that results in a release or threat of release of a hazardous substance.

In those cases where first subsequent purchaser immunity is insufficient to facilitate the sale of property by the FDIC/RTC, we expect that the EPA (utilizing either the Superfund or the Leaking Underground Storage Tank Trust Fund) or State EPA would seek to require the responsible parties to clean-up the property (the FDIC/RTC would not be responsible parties pursuant to proposed FDIA section 36(d)(1)).

Q3. If the EPA, State EPA, or third parties (other than the first purchaser) fund and manage the clean-up, what concerns does the Treasury Department have with the costs to the FDIC or RTC of holding assets pending clean-up?

A3. The Treasury Department believes that the FDIC/RTC should, in order to minimize costs associated with holding property, seek to sell or otherwise dispose of property as expeditiously as possible. We believe that the subsequent purchaser immunity provisions of S. 651, if amended as discussed in A2, will facilitate this as well as our environmental objectives. If the EPA, State EPA or third parties fund and manage the clean-up because the property could not be sold even with first purchaser immunity, we expect that such actions will be taken as quickly as possible to minimize the length of time the property is unmarketable by the FDIC/RTC.

Q4. What are the Treasury Department's views on legislation that would provide that, if a purchaser did not fund and undertake the clean-up, the FDIC or RTC either could do so (1) pursuant to a clean-up plan that received accelerated review and approval by the EPA and (2) subject to timely reimbursement from the Superfund, Leaking Underground Storage Tank Trust Fund, or other appropriate Federal fund and assignment of any contribution claim of FDIC/RTC against third parties to the appropriate Federal fund, or could abandon the asset to the appropriate Federal fund?

A4. As indicated in Treasury's formal statement submitted to the Committee at the June 12 hearing, the Department believes that first subsequent purchaser immunity should be conditioned upon a formal commitment of the purchaser to clean-up the property consistent with the National Contingency Plan. If the first subsequent purchaser then fails to complete the clean-up, we believe the immunity should terminate and that the purchaser should become liable for the clean-up under applicable provisions of law.

We further believe that once property has been transferred by the FDIC/RTC to a first subsequent purchaser, the FDIC/RTC should, consistent with the provisions of S. 651, have no further obligations with respect to the environmental condition of the property. As such, the Department would not support legislation that would impose any responsibility on the FDIC/RTC concerning the property following the transfer to a first subsequent purchaser.

Q5. Is it the view of the Treasury Department that the proposed EPA rule would have the force of law within the Eleventh Circuit so as to override the Fleet Factors decision? Would that result be made more certain through the enactment of legislation?

A5. It is the view of the Department, based on consultations with EPA and the Department of Justice, that the EPA rule, as a legislative rule, would have the force of law. However, in order to remove any doubt concerning the effect of the EPA rule, and as stated in my formal statement, the Administration would support legislation that enacts the lender liability provisions of the EPA rule.

Attachment

Finally, if depositors choose whether to have their deposits insured or uninsured, uninsured depositors who sustain losses will not appear to be the victims that they often appear to be under the current system. Consequently the pressure to payoff uninsured depositors in the absence of systemic risk will be reduced.

There are, however, potential drawbacks to the interest-rate cap concept. It could result in arguably unfair competition between the insured accounts of community banks and the uninsured accounts of large banks. The large bank would have an advantage in the following two respects: first, it would have the benefit of being perceived to be "too big to fail," despite the actual effects of the constructive ambiguity doctrine; and, second, even aside from the "too-big-to-fail" perception, depositors could use size as a proxy for safety in subjectively evaluating the risk-return profile of a large bank. In addition, like any system in which a depositor can easily move funds from insured to uninsured status, this concept could cause increased volatility of deposits from insured to uninsured accounts. Furthermore, capping interest rates on insured accounts alone would not significantly reduce the use of brokered deposits or pass-through coverage, however. The availability of multiple insured accounts and different legal capacities would be relatively unaffected by interest rate caps.

Depositor Preference

In simple terms, depositor preference means that, in the event of bank failure, depositor claims have priority over those of other creditors. Depositors, in other words, receive full payment of their claims before any liquidation proceeds are advanced to other creditors. Alternatively, in the absence of depositor preference, depositors and other general creditors share the liquidation proceeds on a pro rata basis. At present, depositor preference laws, applicable to state-chartered banks, exist in some 23 states, but no equivalent federal statute exists for national banks.

When depositor preference is applicable, the FDIC generally has tried to effect P&A transactions whereby only deposits are assumed by the acquiring bank. Nondeposit creditors are only entitled to receive liquidation proceeds after depositors are fully paid, and since the FDIC stands in the place of depositors, nondeposit creditors do not receive anything until the FDIC is fully repaid for any cash advanced or payment made to effect the P&A. Their subordinate position effectively subjects nondeposit creditors to greatly reduced protection.

Depositor preference has been particularly effective in cutting off contingent claims related to lawsuits, letters of credit, and loan commitments, which in some instances could have imposed substantial costs on the FDIC. Most of the affected failed banks have not had significant unsecured, nondeposit financial liabilities, and they have generally been too small to have substantial off-balance-sheet activities. When the FDIC sought federal depositor preference legislation in 1986, it was the larger banks that objected strenuously. They argued that in a bank failure, creditors whose claims derived from letters of credit and other guarantees might expect to recover little, if anything, from liquidation, and the same would apply to foreign-branch deposits if the preference applied to domestic deposits or deposits subject to insurance. This, they maintained, would substantially hamper their ability to compete with foreign banks and nonbank financial institutions in these markets.

In principle, this problem could be avoided if large banks moved certain of their activities to the holding company, thereby removing them from the advantages or disadvantages of deposit insurance. However, many bank holding companies have little (frequently negative) equity apart from their investment in their principal bank. Few would be able to compete without their lead bank.

The enactment of nationwide depositor preference legislation could have many positive effects. It could reduce the FDIC's failure-resolution costs because the FDIC would be reimbursed on its claims before nondeposit creditors. It might make it easier to adopt failure-resolution policies that enabled creditors to be treated more consistently. Depositors could be protected for banks of all sizes, while nondeposit creditors could be subject to losses more often. Market discipline might thus be increased without resorting to an increase in depositor discipline. There would be fewer concerns over the stability of the system if depositors were not likely to incur losses.

The magnitude of the deposit insurer's gains from depositor preference laws is uncertain because nondepositors can be expected to react to such laws. Hirschhorn and Zervos (1990) found that nondepositors move to collateralize their claims when depositor preference is introduced. In some cases, collateralization has been sufficient to fully offset the benefits of depositor preference to the insurer. Thus, the likely impact of national depositor preference is unclear. (The issue of collateralized deposits is discussed in Chapter XIV.)

Aside from this consideration, the biggest drawback of the proposal appears to be related to the substantial increase in costs for banks competing in certain markets. These additional costs may drive banks, particularly larger banks, out of certain businesses. Many off-balance-sheet activities of larger banks presently offer low profit margins. The prospect of greatly reduced returns (due to the effects of depositor preference laws) to nondeposit creditors may increase costs enough to drive U.S.

banks out of some of these markets. While it is not clear whether such a concern offsets the potential benefits associated with depositor preference, the FDIC's "pro rata" authority provides a resolution method which retains most of the available benefits from depositor preference without imposing such high costs on nondeposit creditors: transactions can be arranged in which all deposits are assumed by another bank, but general creditors receive their pro rata share of recoveries. Such transactions have been utilized successfully to deal with situations where cost otherwise would have prohibited P&A transactions.

3. Increasing Stability

The statutory coverage limit is indicative of the scope of the safety net only in the absence of implicit types of coverage for depositors. Recognizing this, some have concluded that the FDIC's handling of bank failures (whereby depositors typically avoid losses and, in large-bank failures, some general creditors also do) has effectively reduced depositor discipline to minuscule proportions and has weakened several nondeposit sources of market discipline in the process.[19] In other words, this view suggests that the current operation of the deposit insurance system reflects essentially a trade of market discipline at the bank level for virtually complete protection against runs on solvent institutions, despite appearances created by the statutory limit.[20]

This type of argument typically leads to a conclusion that explicit, one-hundred percent coverage is appropriate.[21] It suggests that there is virtually nothing to lose in the way of depositor discipline, and there are several gains to be made.[22] First, full coverage could result in somewhat greater stability than is now common, eliminating some uncertainty and perhaps providing an environment that would allow for a more orderly resolution of failures. Recalling that a major function of deposit insurance is to remove the economic inefficiency associated with the threat of runs, full coverage does this most certainly and completely. Second, it would produce a more equitable system in that large depositors would be treated equally regardless of the circumstances surrounding a bank failure, and small banks could compete for large deposits on more equal footing with big banks. Third, although full coverage could completely eliminate depositor discipline, it could increase market discipline overall if nondeposit creditors faced certain loss in the event of a bank failure. Finally, full coverage would not change the FDIC's failure-resolution costs appreciably under current methods of handling large-bank failures and, with minor changes in failure-resolution procedures under a full-coverage scheme, the fund's risk exposure could probably be reduced (FDIC (1989) and Silverberg (1988)). (As noted above, insurance, interest rate caps might be used under a full-coverage